Consumer Finance Monitor Podcast (Season 8, Episode 24): Everything You Should Know About the Stablecoin Bill

Speakers: Alan Kaplinsky and Art Wilmarth

Alan Kaplinsky:

Welcome to the award-winning Consumer Finance Monitor podcast, where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry.

This is a weekly show brought to you by the Consumer Financial Services Group at the Ballard Spahr Law Firm, and I'm your host, Alan Kaplinsky, the former practice group leader for 25 years, and now senior counsel of the Consumer Financial Services Group at Ballard Spahr. And I'm very pleased to be moderating today's program.

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Okay. Well, I'm very excited today because I have a repeat guest. I haven't even been able to count how many times Art Wilmarth has been a guest on our show, but he is truly an expert in a lot of the consumer finance areas that we follow very closely. And the topic we're going to talk about today is Stablecoin, which is a type of cryptocurrency. And Art Wilmarth is truly an expert on crypto. He is the emeritus professor at George Washington University Law School. He also has done and continues to do a lot of work for the Conference of State Bank Supervisors. He has written amicus briefs for them in a variety of different cases, and he's already written very prolifically on the subject that we're talking about today.

And in fact, he recently in the March 6th edition of BankThink, I'm going to just give you this a couple of sentences, this is a quote from his article about something called the GENIUS Act, which you'll be hearing a lot more about as our program goes on today. But that is a bill that's passed the Senate Banking Committee and by a bipartisan margin, and it purports to regulate stablecoin and more importantly than that, to really open up the door for non-banks to potentially get into what many people will consider the banking business and the quote I have, and that's how I'm going to end my introduction, and have I got a lot of questions for Art today.

"The GENIUS Act is an ill-conceived bill that will allow the largely unregulated sale of stablecoins to the public. The risks it poses for investors, the financial system and the broader economy are unacceptably high." Other than that, you love the bill, right, Art? Seriously, Art a very warm welcome to our program. Delighted to have you as a repeat guest.

Art Wilmarth:

Well, thank you very much, Alan. It's always a pleasure to be with you and to discuss these important issues. So thank you very much for giving me the opportunity to do so today.

Alan Kaplinsky:

Okay. So I always like to build foundations for our listeners before we get into the more complicated issues. There're going to be people who are experts listening to us today, experts in crypto, but there'll be people who don't know what the heck is a stablecoin. I, in fact had breakfast this morning with my wife and I told her we were doing a podcast show about stablecoins. She didn't know what a stablecoin was. So question number one, what in the world are stablecoins and what are their present uses?

Art Wilmarth:

Yes, so a stablecoin is one of perhaps three broad categories of cryptocurrencies. All of these cryptocurrencies reside on one or more blockchains, the distributed ledgers.

So the first cryptocurrencies were fluctuating value cryptocurrencies such as Bitcoin, which was probably the first major cryptocurrency to attract public attention. So Bitcoin and Ethereum and similarly fluctuating value cryptocurrencies don't promise to maintain any stable value. They are widely traded and essentially their price goes up and down really quite radically based on market conditions and investor demand.

There's sort of a second category called memecoins, which are sort of unique artistic, sports, collectible, essentially digital representations. They're kind of a special category. It's sort of like collecting stamps, works of art, whatever. Again, it depends on what the interest in them is, but they're generally not widely invested.

And then stablecoins came along beginning in 2014, but not really in large numbers until about 2020. And the idea of a stablecoin is that the issuer says, I will make my best efforts to maintain a stable value for this stable coin by maintaining parity with some kind of reference asset or referenced group of assets. By far, the most widely used reference asset is a US dollar. About 98, 99% of all stablecoins essentially represent or promise that they're going to maintain parity with the US dollar, one stablecoin, $1. They essentially are a payment instrument and we can talk about how they're used.

Alan Kaplinsky:

First of all, I think you've already answered what I was going to ask you, but is there anything you want to add in terms of how they differ from other types of crypto, like Bitcoin? And I think you already answered that by saying Bitcoin's not tied to any currency.

Art Wilmarth:

I mean, Bitcoin supposedly has a limit on the amount of issuance, sort of an artificial sort of scarcity that might or might not limit its price swings, but certainly it's been radically fluctuating in the past.

What stable coins have been largely used for is for investing and speculating in fluctuating value of cryptocurrency. So as many people have said, stablecoins are like the poker chips that you buy the poker chips by cashing in your fiat currency, you get the stablecoins and then you use the stablecoins to buy and sell cryptocurrencies like Bitcoin and Ethereum and others because the exchanges, the crypto exchanges in a sense want a blockchain-based payment instrument to engage in these trading and lending, pledging transactions.

There's also, I think some reason to think that people believe that if they use stablecoins and they put them in private digital wallets, which are essentially private digital custodians that they control that you can transact on crypto exchanges and people will know the number of your key, but they won't know who you are. So you get some degree of what they call pseudonymity from doing that, as opposed to if you bring fiat currency and you bring that onto the crypto exchange, if they allowed it, people would be able to trace you very quickly.

Alan Kaplinsky:

Yeah. So are you saying that if I go to a crypto exchange, let's say like Coinbase, and I want to purchase Bitcoin, I can't use US dollars to do that? I've got to first convert my US dollars into stablecoin and then use the stablecoin to invest, if I want to, I don't have to.

Art Wilmarth:

Right, right.

Alan Kaplinsky:

In Bitcoin or Ethereum or something else. Are there any other use cases for stablecoin or is that?

Art Wilmarth:

It is sort of interesting. So the stablecoin advocates will tell you that there are other use cases, and there does seem to be some degree of use of stablecoins for cross-border payments and for even in-country payments in countries that have wildly inflationary currencies, the currencies are moving up and down, that have unreliable or inaccessible banking systems or banking systems that require very large fees to conduct transactions.

So you see some use of stablecoins in these emerging economies that don't have good traditional banks and payment systems or whose currencies are very unstable. You don't see stablecoins, at least today, you don't see them used or general payments purposes in the United States or in any other major developed country like the EU or the UK, Japan, so on.

Alan Kaplinsky:

I take it though, Art, that in the future that companies that issue stablecoins, isn't it their hope that eventually it will be a type of payment instrument similar to a credit card or a debit card that you'll have in an electronic wallet on your phone? You'll be able to use it for any kind of a transaction that you want, go out to McDonald's or even you go to buy a newspaper, you'd be able to pull out an app that you have that's got stablecoin loaded on it. In effect a substitute for hard currency, that would replace currency. Isn't that the dream?

Art Wilmarth:

Yes. That's certainly what the advocates say. Now, it's interesting. There are a number of challenges with blockchain-based technologies like stablecoins.

So clearly, because blockchains are in a sense publicly accessible, they're not like what's called a permissioned bank ledger or permissioned ledger that has a centralized counterparty controlling access. So these public blockchains have been subject to a number of hacks. Just recently, BYBIT suffered a $1.5 billion hack from a North Korean group of hackers. So that there are questions as to how secure they are.

The other problem is that their interoperability is not very good. There's one blockchain doesn't necessarily talk to another in a very seamless way. And then you compare it to what we have. Okay, so what we have is a payment system that has developed obviously over centuries, and the Fed came in 1913 and one of the big functions of the Fed is to create a more seamless payment system among our banks. And they have done that steadily over time. For example, we saw checks essentially go digital and electronic checks about 20, 25 years ago. That was a huge step forward. Now we have something called FedNow, which is not fully implemented. It's coming and it should be fully implemented, which is to provide instant real time payment services among banks and their customers. The Clearing House has its own sort of competing real-time payments system called the real-time payment network.

So banks in a sense, are moving toward instant real time settlement services. We have a movement toward tokenization of bank deposits, which essentially is similar to the electronic check concept that we are turning deposits into digital representations. Now, the big difference is the banks would put their tokenized deposits on permissioned essentially private distributed ledgers, and you'd have to have permission to get on that ledger and transact on it. The bank would maintain control of it, and of course the bank's ledger would then be linked with all other banks through the Federal Reserve.

So I mean, I think that what I would say is stablecoins purport to be solving a problem that I don't see in the US financial system or indeed in other developed financial systems.

Alan Kaplinsky:

Well, except if you're a non-bank, right? I mean, if you're a bank, you've got access to FedNow, which by the way, I don't think it's been an overwhelming success so far. At least that's what I've heard anecdotally, that it's very expensive and there was a hope that a lot of community banks would start using it, and I don't think it's caught on yet. Maybe it will in the future. But the government was pretty late to the game, I think with FedNow, and I at least heard from my clients they are sticking with real-time payments.

Art Wilmarth:

Right, right. For the larger banks, that probably makes sense, yeah.

Alan Kaplinsky:

And then on the digital tokens, I didn't realize they were on the blockchain as well. Are any banks offering... I'm sorry, digital deposits. Are there any banks that are offering digital deposits right now?

Art Wilmarth:

Most banks I think are engaged in what... The larger banks are engaged in, what I would call testing, proof of concept testing. There was a Federal Reserve study done, experiment done a couple of years ago where banks were using digital deposits on distributed ledgers to facilitate clearing, mainly inter-bank clearing, particularly inter-banks, banks in different countries. And there are about 12 or 14 large global banks that cooperated with the New York Fed in that study.

So I think it is a concept is coming. The question is the Fed has the ability to create a seamless system linking all participating in banks who qualify to serve. I have great questions about an entirely private system existing outside the Fed.

Another problem with blockchains is if you make a mistake or there's fraud, it's very hard to undo a public blockchain. I mean, it's almost impossible. So there's a real problem with correcting mistakes or correcting fraud. Actually, that came up in BYBIT. They sort of said, "Well, hey, can we go back and essentially unwind the transaction that involved the North Koreans?" And they said it would be too disruptive. The rest of our customers would be very upset.

So I think you're right. The critical question that the GENIUS Act raises is first, should non-banks be able to offer essentially a payment substitute, and how does that payment substitute essentially coexist with the Fed system? I believe that what the implicit purpose of the GENIUS Act is, is to get this alternative system up and running and then say, "Now we're going to give these non-bank stablecoin issuers access to Fed Master accounts. They'll have access to all the Fed's clearing services, settlement services, and the subsidies that go along with it. And so they will get the same payment rails that regulated banks get. And my view is that essentially arbitrages and undermines the integrity of our bank regulatory system.

Alan Kaplinsky:

Yeah, yeah. Well, before we get too much into the weeds here, I am trying to get some idea, Art, of the size of the stablecoin market today. Do you know roughly how many companies are issuers and what the total volume in dollars might be of outstanding stablecoins? And has this thing been growing and... Well, I'm just trying to get some idea of stock.

Art Wilmarth:

So the stablecoin market was probably only about $6 billion in early 2020. It grew very rapidly during the crypto boom to about $180 billion at the end of 2021, early 2022. And then we had the extended crypto winner once the Fed started hiking interest rates, and they went back down to about 130 billion.

Now, we've sort of experienced a second crypto boom in 2024, and stablecoins have been pushed up to about 230 billion currently. And although the crypto market had some pretty rough [inaudible 00:19:06] in the last couple of months, stablecoins have remained at about 230 billion. I think partly because of this legislation that they think that the legislation is going to give them more value and more clout outside the crypto trading system. They won't just be crypto poker chips, as you say, they may graduate to a more generally used, form of payment, but it's about two 30 billion right now.

And there are two companies that dominate it. So you have Tether, which is a shadowy company now essentially licensed in El Salvador that has just over 60% of the market. And then you have Circle, which is the largest US company that has about 25% of the market. So essentially two big issuers have about 85% of the market. There's some smaller issuers like Paxos Trust and PayPal. I think the top five to 10 issuers certainly have 95% or more of the market. So it's a very concentrated market at the moment.

Alan Kaplinsky:

Yeah. So why would I, all right, I'm not interested in going on a crypto exchange and using the poker chips to buy Bitcoin. Is there any other reason, assuming you were marketing, you were an issuer and you're marketing stablecoins, why shop buy a stablecoin from you? Is it an investment that I can hold and earn a rate of return on, or is it just, say, when I go out with my friends for dinner, I can drop the word, "Hey, I own some stablecoin. What do you think about that?"

Art Wilmarth:

The GENIUS Act says that issuers, the issuer of a stablecoin, like Tether or Circle, may not pay interest on them. And that was put in as a concession to the banking industry saying, "We aren't trying to create another money market mutual fund, which will just intermediate the banking system like the original money market fund did," because there won't be any yield.

But that's not really true because if you go to Coinbase, which is a partner with Circle and equally shares the revenue from the Circle's USDC stablecoin, Coinbase will pay you 4.1% if you hold your USDC stablecoins on their exchange. If you go to Binance, they'll pay you 11% if you hold your USDC stablecoins on their exchange. So if the exchanges can pay that type of yield, it absolutely is a money market investment or even possibly better than a money market investment. And that will definitely compete with the bank deposits because people will say, "Hey, I can't get 4% or 11% on my bank deposits," and instead of holding money market funds, "Hey, I'll put some money in stablecoins even if I don't want to use them." As you say, for transacting payments on crypto exchanges.

Alan Kaplinsky:

Well, if this law goes through prohibiting the payment of interest, I take it that the stablecoin issuers and the exchanges aren't going to like that law, right?

Art Wilmarth:

Well, the exchanges are not prohibited from paying yield. That's a huge loophole in the bill. In other words, if the bill said neither issuers nor exchanges can pay any yield, I think that would make stablecoins pretty sterile, essentially.

But I think it's a huge loophole that they say issuers can't pay interest, but there's no prohibition against exchanges offering the kinds of yields that we were discussing. And I think that's an intended loophole, frankly.

Alan Kaplinsky:

Interesting. So the stablecoin issuers, well, you said there's a Circle and then there's one in El Salvador-

Art Wilmarth:

Tether, yeah, Tether.

Alan Kaplinsky:

... and they pay interest right now, I think you said like 4.1% or something like that. So I'm curious, how do they make money? If I go to buy stablecoin from Circle, do I have to pay a commission? Where's the revenue? How does Circle or an issuer generate revenue?

Art Wilmarth:

The degree to which Circle pays interest, I am not quite sure. But what they do is they have these reserves, which include Treasury bills, money market funds, repos with Feds, repos with private counterparties. So they get yield on all those assets. And if interest rates are reasonably high as they are right now, they're probably getting a four to 5% yield on those assets. And to the extent that they would pay out less than that, there's obviously a spread.

And as you say, they charge transaction fees also, the transaction fees are often not so easy to figure out. But my understanding is if you want to redeem your stablecoins, you generally don't do that for free. There's some kind of a charge.

Now, interestingly, the GENIUS Act says that stablecoin issuers must publicly disclose their redemption policies, but it doesn't say how long they have to redeem, whether it's one day, two days, three days, seven days, 30 days, and they also don't say anything about transaction fees, which again, to me are significant gaps in the bill because-

Alan Kaplinsky:

Well, yeah, that's before we, again, get too far into the bill. I guess I have a question, a very basic question, and that is, as things stand today, is there any regulation of stablecoins either at the federal level or at the state level?

Art Wilmarth:

Essentially you have the money transmitter laws in the various states, and so to really be compliant with state law, certainly Circle has money transmitter licenses. As I say, Tether is a very shadowy operation because they were at one point sued by New York and the Commodities Future Trading Commission back in 2021 for not being transparent and truthful about their reserve policy and misleading customers. And I believe that Tether essentially said that they wouldn't sell stablecoins in New York anymore after that.

So stablecoin, I mean, Tether exists this sort of very large, but very shadowy offshore operation, and I think supposedly Tether says that it won't directly offer stable coins to US customers, but you can go on any major exchange like Binance US, or Coinbase, and probably get access to Tether through those exchanges because, quote, "they're not controlled by Tether" or they're not affiliates of Tether.

Alan Kaplinsky:

Right, right. But am I right, at the federal level, there's no regulation at all?

Art Wilmarth:

Except for the FinCEN, AML, KYC, BSA sanctions. So yes.

Alan Kaplinsky:

Anti-money laundering laws?

Art Wilmarth:

Yeah, the sanctions, certainly stablecoin issuers have gotten wrapped up in various money laundering and sanctions avoidance. And in fact, Tether has been accused of facilitating all sorts of money laundering, sanctions avoidance, other criminal activities. Now, Tether claims that it doesn't and that they cooperate, but there's a lot of controversy about it.

I mean, I'm not saying that USDC, to my knowledge, has not been dragged into those types of AMLs, KYC, BSA, money laundering issues. To my knowledge they haven't. But Tether has been very controversial.

Alan Kaplinsky:

So another sort of foundational question, I guess you could say, is you said that stablecoin has to be tied to a US currency, but doesn't it also have to be, in effect, secured? That is there's got to be dollar for dollar value of security behind the stablecoin? That's how they're able to market that it's not subject to market fluctuations. It's a stable price.

Art Wilmarth:

Right. In many ways, they resemble the prime money market funds, right? And the prime money market funds claim that although there was a lot of fine print, they would say dollar in, dollar out. And then we found out that in 2008 and 2020, when the repo market and the commercial paper market got into trouble, in fact, you couldn't depend on getting dollar in, dollar out, and the Fed had to bail out, and the Treasury had to bail out prime money market funds twice.

Well, you have the same problem with stablecoins. What are the quality of reserves behind them? Now, again, Circle will say, we have Treasuries, we have money market funds, we have repos, and supposedly they're adequately liquid. And the GENIUS Act would put limitations on the kinds of reserves you could have. I mean, Tether is much more shadowy that allegedly they have commercial paper issued by Chinese companies of doubtful credit worthiness. Their disclosures about their reserves are not very transparent or comprehensive.

Alan Kaplinsky:

Are you saying... You said they all have licenses under state money transmitter laws, which I think exist in maybe all 50 states or 49, 50. Don't they regulate? Don't they already specify how the security that's got to be maintained? Or I guess would you call that-

Art Wilmarth:

Yeah, there are regulations, and I don't profess to be an expert on money transmitter laws. If you look at the work of Dan Awrey at Cornell Law School who's really examined these laws very carefully, he says that many of them really don't provide adequate security, particularly for, as you say, payment instruments that are promised to be one for one, and payment instruments that are held over long periods.

It's one thing to say if you're a Western Union or MoneyGram and you're only holding the customer's funds long enough to transmit them, there's not much duration risk there. But these stablecoin issuers, they're basically holding your funds like a money market fund for a long time. And I think it's fair to say that the money transmission laws in the States are certainly not as demanding as the SEC's rules for money market funds. And as we've seen, the SEC's rules for money market funds were not adequate when you had major financial crises happening in 2008 and 2020.

Alan Kaplinsky:

Yeah. Well, I know that you're not a fan of the GENIUS Act, but wouldn't you agree that if the money transmitter laws don't provide sufficient protection against loss to consumers that there are only two ways to go? One is to get those state laws amended, but that's a big job. You got to go to the Uniform Law Commission and then you've got to go state by state to get it enacted. Or you need protection at the federal level.

So shouldn't there be some [inaudible 00:31:12]. These issuers aren't going away, even if the GENIUS Act doesn't pass, they'll continue to stay in business. It's a growing business, so there's a need for protection, right?

Art Wilmarth:

Yeah. So I've been concerned for a long time by PayPal's business model in particular, because my understanding was up until about somewhere around 2012 or '13, PayPal, basically the money that people put with PayPal that it was holding for customers was rolled into bank deposits and covered by pass-through deposit insurance.

And then about, again, 10, 12 years ago, that changed. And so the last time I saw PayPal's balance sheet, which was at the end of 2024, they had about $40 billion of customer funds that were not held in bank accounts, not covered by pass-through deposit insurance. And to me, that behavior, much like a non-bank stablecoin, is a deposit. And so interesting that we have a federal law, which is 12 U.S.C. 378, which says non-banks may not engage in the business of accepting deposits. That's goes back to the Glass-Steagall Act of 1933. And my view is what PayPal is doing, as I understand it, is deposit taking.

And I think these non-bank stablecoins are deposit taking because what's happening in both cases is a non-bank is taking your money and saying, "I will return it to you either on demand or within a specified time, but in the meantime, I'm holding custody of it and I will also transfer it to third parties if you want me to do that." And that's only what PayPal says, and that's what Circle says. So to me, it certainly flies, swims, quacks like a duck, so it's a duck, it's a deposit. And that should not be done outside the banking system.

So my idea of federal protection is I'm entirely comfortable with Western Union and MoneyGram that, say, take your money and transmit it, and the money is in process. They're not holding it for any length of time longer than to transmit it. That's a payment function, and I'm comfortable with that. But not when people are holding your money and saying, "I'm going to hold it for you, and then you want it back, I give it back and I'll transfer it to a third party," that's a deposit. And my view is that that belongs within FDIC insured banks, not within non-banks.

Alan Kaplinsky:

Are any banks today issuing stablecoins?

Art Wilmarth:

Interestingly, just yesterday, Custodia, which as you know, is a Wyoming special purpose deposit institution, really a crypto bank, announced with something called Vantage Bank. I'm not familiar with Vantage Bank, that they were going to do a stablecoin on Ethereum. That would be a bank stable coin. They didn't say much about what their business model business plan was.

There had been a previous stablecoin venture that I think ended, and I'm trying to remember whether it was involving Customers Bank, may or may not have been. But anyway, after Signature Bank and Silicon Valley Bank went down, and they were both involved with crypto, I think the FDIC indicated that they weren't very enthusiastic about this stablecoin venture. I think it was discontinued.

So as I say, tokenized deposits are different because they're on private permissioned ledgers that are not public and that they're controlled by the bank. The idea of putting a bank stablecoin on a public blockchain like Ethereum, I mean, this is the first time I've seen that kind of proposal made really in the past, I would say, certainly since the spring of 2023. And it'll be interesting to see what that business model looks like, but it is a bank issued stablecoin, which I presume, they didn't make clear whether it's an FDIC-insured product or not. That was not said, at least not from what I saw.

Alan Kaplinsky:

Right. So Art, let's turn to the GENIUS Act now. We'll take that deep dive. And maybe you could give us, just tell us what are the main features of that law, and then I'm going to ask you, after you've described it, what's your problem? What's your critique of that law?

Art Wilmarth:

I think in broad strokes, what the GENIUS Act says is we are going to authorize three general categories of stablecoin issuers.

First, which to me is least controversial, we would allow subsidiaries of federally insured depository institutions to issue stablecoins. They wouldn't be federally insured, but they would be subsidiaries of federally insured depository institutions. So there's at least an implicit understanding that there's a federal safety net under the parent of the issuer. So that's the least controversial.

The second one is we will allow the Office of the Comptroller of the Currency, the regulator of national banks, to charter and regulate non-bank stablecoin issuers. These would not be subsidiaries of national banks. They would be completely independent non-banks. And they could be owned essentially by anyone because they wouldn't be a bank. They wouldn't be subject to the Bank Holding Company Act. So any commercial enterprise, including a big tech firm, could own one of these things. That would give the OCC, in my view, primary jurisdiction and authority to set stablecoin policy for non-banks. The third category would be state-

Alan Kaplinsky:

And they would actually charter, the OCC, the way they would charter a national bank? They wouldn't be called a bank, though. They couldn't use that word, I guess.

Art Wilmarth:

No. And they would be similar to the OCC special purpose trust companies, one of which I can't remember. I think Figure is like a special purpose crypto trust company, and I think it has dabbled with the idea of issuing a stablecoin, I don't think it has.

But this would be similar to a special purpose trust company, except the difference would be a special purpose trust company is still considered a national bank, but with limited trust powers. This would be, as you say, a federally chartered non-bank, not a national bank with stablecoin powers. And we'll talk about... There's also a very troubling provision that says the OCC could allow any other activities for the stablecoin issuer that it decided were appropriate, sort of an open-ended grant of additional authority.

Now, the third category would be state-chartered stablecoin issuers, which could presumably be either uninsured depository institutions like the Wyoming SPDIs, the Special purpose depository institutions, or could be non-banks. These would be regulated by the states.

Alan Kaplinsky:

Would include if you had a money transmitter license?

Art Wilmarth:

Yes. It doesn't really speak much as to the interaction between the GENIUS Act and the money transmitter license. That would be an interesting question. I think I saw a draft of the House stable, so-called STABLE Bill, which would sort of indicate that if the state regulator is doing something permitted by the Stablecoin Act, any conflicting state law would be preempted. So that would presumably override any money transmitter laws. As I say, I just saw that provision and I haven't seen a real analysis of it yet.

Alan Kaplinsky:

But what I'm getting at, I don't know if you can figure it out from the statute, because I know there's a lot of ambiguity in it, is you really have two choices.

Well, if you're going to... You can get a federal charter from the OCC, but if you elect not to go that route, if you are chartered under some state law, that's also covered by the statute. And right now, to my knowledge, there aren't any state licensing provisions anywhere dealing with stablecoin as such, but they are swept within the money transmitter laws. So are the state's going to have to set up a whole new chartering system?

Art Wilmarth:

No, I think... Right. The state would have to set up a system that would be considered substantially similar to the federal system for stablecoin issuers. The Treasury Department would have the authority to determine whether the state system was substantially similar, but the bill doesn't give much guidance about what substantially similar means.

Now, one of the key points in the GENIUS Act is that you can stay within the state system until you have 10 billion of outstanding stablecoins. At that point, you are supposed to transition to federal supervision, federal charter, within 360 days. But the appropriate federal regulator, and it's not clear exactly who that is, at least to me, could give you a waiver that would allow you to continue under state supervision even if you have more than 10 billion of stablecoins outstanding. Which I think, again, is a huge loophole under the law. And again, the state regime would only have to be substantially similar.

And the federal regulators, the Fed and the OCC, would only have essentially emergency backup authority. They could only come in, in two circumstances. One is the state signs a memorandum of understanding and allowing them to come in and regulate and supervise the state-chartered stablecoin issuer. Or the federal regulator, which could be the Fed or the OCC determines that a state stablecoin issuer is violating or about to violate a law or is in very bad financial condition, and they need to act exigently to deal with that. But the state stablecoin issuer already in serious trouble before the federal people can come in, which again, is not a very good situation.

Alan Kaplinsky:

What else is in the GENIUS Act? We talked about the chartering options, but does it say anything about what kinds of reserves have to be held to back up the issuance of the stablecoin?

Art Wilmarth:

Yeah, so essentially Treasury bills with maturities up to 93 days, which to me presents some interest rate and market risk. Repos with the Fed, backed by 93-day Treasuries. Repos with private parties backed by 93 day Treasuries. Although the maturities have to be much shorter on the repos than that. I think under the GENIUS Act, the repos can't have maturities longer than seven days.

Bank deposits, deposits in federally insured banks. But the problem is they could include uninsured deposits, and that became an enormous problem when Circle held $3.3 billion in Silicon Valley Bank when it went down and there was a run on Circle, and many people, including myself, believe that the bailout of Silicon Valley Bank was in large part a bailout of the crypto markets and the bailout of Circle.

And the other thing is they can also put reserves in SEC-approved money market funds. So what you see happening is now you're linking at least four unstable markets together. You're linking stablecoins that aren't federally insured, uninsured bank deposits, money market funds that aren't federally insured, and private repos that aren't federally insured. And of course, you can say, well, the collateral looks good, the backing looks good, but we know that in 2008 and 2020, when there's a systemic general financial crisis, every uninsured market is going to crack and have runs, and the Fed and the Treasury are going to have to come in and bail them all out.

Alan Kaplinsky:

Well, and they bail out the money market funds.

Art Wilmarth:

Yes.

Alan Kaplinsky:

Yeah. I mean, has any consumer ever lost a dollar or a penny in a money market mutual fund or a 93-day T-bill? Probably not. Right?

Art Wilmarth:

I don't think so. I mean, there clearly was a threat that they would if the Fed and the Treasury didn't intervene. And I think this is the problem that when you create an uninsured category of short-term financial claims and you put the federal government stamp of approval on it, so we put the federal government stamp of approval on money market funds through the SEC.

We're now, under the GENIUS Act, putting the federal government stamp of approval on uninsured, non-bank stablecoins. The public is certainly going to believe and expect that the federal government is going to stand behind these things when they get into trouble. Now, the GENIUS Act says, "These are not federally insured. You can't say they're federally insured." But the expectation is exactly as you say, the federal government is not going to let a major category of uninsured federally approved claims go bust because they know that that will ignite a run on every other category of such claims.

Alan Kaplinsky:

Yeah, yeah. So let me ask you, we talked about reserve requirements, we talked about chartering. Are there other features of the GENIUS Act that you think you should highlight?

Art Wilmarth:

Yeah, there are capital and liquidity requirements, but they're very constrained. They have to be tailored. They can't require the issuer to have more capital or more liquidity than would be sufficient to allow it, as they say, to meet its obligations. In other words, there doesn't seem to be much leeway for regulators to require additional buffers, protective buffers beyond the 100% reserve requirement.

Another problem, they say specifically, you cannot apply the Collins Amendment, which is the general provision requiring banks and bank holding companies to comply with risk-based capital and leverage capital requirements that apply to banks. So they're saying you can apply bank capital requirements to these things. Which again, gives them a big advantage over banks, right? Because they will have lower capital requirements and lower liquidity requirements. There is no resolution process other than bankruptcy. Okay? There's no FDIC receivership. The only thing that can happen is that these things go into bankruptcy.

Alan Kaplinsky:

Why is that a bad thing?

Art Wilmarth:

Well, as we know, bankruptcy is a very slow and cumbersome process. I mean, I think the Lehman bankruptcy took something like five to seven years to resolve. The FTX bankruptcy was just completed in two years, and they all celebrated and congratulated themselves on, hey, this was like a record time to get this done in two years. Of course, part of the reason they could do that was that the crypto market recovered and people's losses could be pretty much covered.

But if you were told, "Oh, if you go into bankruptcy, you'll wait two years for your money." How many people would like that deal? I mean, that again, will obviously encourage people to run. They're not going to wait two years. And there's some complex provisions that are similar to the depositor preference provisions in the FDIC Act, arguably depositor preference plus. But it still, to me, doesn't give you priority over truly secured creditors, or particularly the so-called super priority creditors like derivatives, counterparties, and repo counterparties.

And the problem with bankruptcy is if an issuer goes bankrupt, by definition it's insolvent. It doesn't have enough money to cover the claims. Now you then say, "Okay, who is going to cover the claims?" There's no federal fund. There's no deposit insurance fund. There's no federally supervised guarantee fund. So there is no fund, again, unless the Fed and Treasury come in and arrange a bailout. So to me, bankruptcy means you won't be fully covered. You'll wait at least two years, which means you'll run. This will not give anybody any assurance that they'll be covered.

I mean, it's relevant to think about what happened with Silicon Valley Bank. As you remember, the FDIC at first said, "Oh, we're going to cover all insured depositors, of course. We'll take care of them right away. For the uninsured, we'll pay a fifty-percent dividend right away, and then we'll wait to see how much we get," and you may get a hundred percent, or you may not.

And that set off... It set off the beginnings of a systemic run until they stepped in and said, "Okay, we're going to protect everybody, including everybody at Signature." So I mean, we should have learned by now that again, if you have a federally approved uninsured short-term financial claim, people are going to expect either the federal government steps in and protects a hundred percent, or we run. And my view is that's a recipe for disaster.

Alan Kaplinsky:

Yeah. So let me ask you this. In terms of dealing with the consumer who's going to be buying stablecoins, and assume the GENIUS Act becomes the law, are there any disclosure requirements in the GENIUS Act? Does it require issuers to... Well, I guess they're happy disclosure, it's not an insured deposit, but are there other things?

Art Wilmarth:

Yeah, so they have to disclose their redemption policy, although it's open-ended what that would be, but they have to disclose it. They have to publicly disclose, I think, on a monthly basis and attest to their reserves. As you say, they have to disclose, they're not federally insured.

There are custodial segregation requirements, but again, I'm not an expert on those, but I think that they are considerably weaker than the custodial and segregation requirements that apply to investment advisors and broker dealers under the SEC's rule. So again, it seems to me they could have borrowed the SEC's custodial segregation requirements, and they didn't.

The other problem is that there's no reference to the Consumer Financial Protection Act. Now, I think if you look at the Consumer Financial Protection Act, you could certainly say that these stablecoins are a form of payment, and they are a custodianship or a holding of funds, so they are a consumer financial service and they are protected by the CFPA. But that's not expressly stated, and I bet the industry is not going to concede that point. I bet the industry will say, "We're not subject to the CFPA, and therefore we're not subject to the Consumer Financial Protection Bureau jurisdiction".

Alan Kaplinsky:

I take it the securities, they're not subject to federal securities laws?

Art Wilmarth:

Yes, they're express carve-out saying-

Alan Kaplinsky:

Express exemption. And it doesn't say that they're not subject to the CFPA?

Art Wilmarth:

No, it's silent, right. But I would think that the industry is going to make that point. And of course, the CFPB under the current administration might agree with them. The CFPB might say, "In order to promote stablecoins, we're going to say that we don't have jurisdiction."

You're right, there's an express carve-out for the federal securities laws. And interestingly, there's also an express carve-out for the CFTC saying that the CFTC doesn't have jurisdiction either, which was not in the original bill, but was put in the manager's amendment when they passed it out of the full committee.

Alan Kaplinsky:

Yeah. What about the Federal Trade Commission?

Art Wilmarth:

No statement about FTC. So again, I think that would be... And probably I think the CFPB would have a better argument than the FTC. I mean, the FTC could certainly try to make arguments about unfair and deceptive trade practices.

I mean, you're right. I mean, what's sort of interesting is to the extent that the industry argues that the CFPA does not apply, that might open the door more to the FTC saying, "Okay, well, the CFPA doesn't apply and the CFPB doesn't have jurisdiction, then we do." Because there's always that interesting dividing line between when the FTC can act and when the CFPB can act, and can they both act. You know more about that than I do.

Alan Kaplinsky:

Yeah. What about supervision? Will the Comptroller of the Currency for a federally chartered stablecoin issuer, will they have the right to examine, come in and examine and... Yeah, they will have that?

Art Wilmarth:

Yeah. So essentially for a subsidiary of an insured depository institution, the primary federal regulator of that depository institution has essentially what looked to be reasonably robust examination supervision and enforcement powers.

Alan Kaplinsky:

And can issue regulations, I assume?

Art Wilmarth:

And enforcement, right.

Alan Kaplinsky:

Yeah. And it can bring enforcement action?

Art Wilmarth:

And the OCC would have that over the non-bank, federally chartered non-bank. The state essentially is a primary regulator over the state chartered stablecoin issuers. And as I said, the Feds only have what I consider to be very weak emergency backup authority, which I think is very problematic over state chartered non-banks issuers.

Now, of course, they argue, well, they won't get too big, but the problem is the federal regulators could give them a waiver to allow them to get quite large.

Alan Kaplinsky:

Is there anything else that's in that bill that you don't like? I mean, you've mentioned a lot of things.

Art Wilmarth:

Right. Well, my primary problem, I would go back to the one that we mentioned earlier, which is to me, this is a deposit taking activity without doubt. This is a core banking function without doubt. This kind of activity should not occur outside FDIC-insured banks for a whole host of safety and soundness and consumer protection reasons.

But on top of that, we will now, I believe, through this bill, allow big tech firms and other commercial enterprises to enter the business of banking and conduct a deposit taking and payment service. I think that will put enormous pressure on the separation between banking and commerce, and probably cause both banks and non-banks to argue that we should repeal the Bank Holding Company Act's provision, Section 4, that separates the two. And I think we will then see the creation of enormous banking and commercial conglomerates that stretch across the entire economy. And we could talk about this further, but look at what happened in China with Ant Financial and Tencent, where they basically controlled the entire consumer financial markets until the government stepped in and cracked down on them.

So once you have banking and commercial conglomerates, now you basically have a situation where banking problems spill over into the commercial non-financial sector, and commercial problems spill over into the banking sector. What I say is that we would then have bankified our entire economy so that when the economy gets into trouble, or the banking system gets into trouble, the federal government will have to do these giant bailouts beyond anything we've seen before.

And if we look at our federal debt, which is quadrupled since 2007, our monetary supply is more than tripled since 2007 because of all the bailouts we've done. Who thinks that we could do another enormous set of bailouts without, I think, risking a dollar crisis, a Treasury crisis, sort of a loss of credibility in our currency? Who thinks the government could take on debt similar to what we did in 2020 and '21, or in 2007 and '09?

So I think that as Europe found out, sometimes too big to fail isn't the only problem you have, you also have too big to save. You simply can't finance what's necessary to save these institutions. I mean, this goes back to my early point. I don't see any benefit to this bill beyond what we can do through our banking system. And I see a host of enormous problems and liabilities that we're creating that I think we simply can't afford.

Alan Kaplinsky:

Right, right. So why is it with all these problems that you've identified, that the Senate Finance Committee by a bipartisan margin of, I think 18 to 6... Not the Finance, I think the Banking Committee, they voted in favor of it, and I guess the next step, it will go to the floor of the Senate. Why is there all this interest-

Art Wilmarth:

Yeah. So it's a very simple, blunt and unfortunate answer, which is that the crypto industry poured $245 billion, by one estimate, into the last election cycle, both presidential and congressional. And essentially the crypto industry effectively got the best administration and Congress that money can buy that. They poured $40 billion into Bernie Moreno's race to knock out Sherrod Brown, for example. And they poured over $100 billion into the presidential race.

And they did this on a bipartisan basis. I mean, they put a lot of money behind new Democratic senatorial candidates in California, in Arizona, in other states. So they have been very targeted and astute in buying the support they need, unfortunately.

Alan Kaplinsky:

So is this a runaway train or is this something that can be... I take it from your standpoint, there wouldn't be any stablecoin bill that would make you happy, Art? You just think there shouldn't be.

Art Wilmarth:

I would be willing to say you would allow FDIC-insured banks to issue these things, and then we would have an experiment. If stablecoins really are better payment instruments than tokenized bank deposits on private ledgers, I would presume that banks would then adopt them as better instruments. But I don't see why we should allow such experimentation outside the regulated banking industry.

I keep hoping that members of Congress will think about their public duties and public responsibilities and will look at these risks and say, "You what? This is not the right step to take." Again, fine, if we could allow banks, FDIC-insured banks to do this activity and find out, maybe then have a three-year study or whatever report back to Congress, is this working out with banks? Or if banks are not doing it, are they not doing it for the wrong reason? I mean, I think we need to learn a lot more about these instruments before we open them wide to everybody.

Alan Kaplinsky:

I take it you wouldn't have, and I don't mean to put words in your mouth, but if non-banks wanted to partner with banks, in other words, to do marketing and to perform either back office functions, you wouldn't have a problem with that as long as the bank will see-

Art Wilmarth:

It would raise the same issues I think that we've seen with fintech partners with banks. And I think what we need to address is the Synapse problem, that if we're going to have essentially fintechs really acting as something like deposit brokers or deposit placement agents, we need to make sure that the record-keeping, the responsibilities, the accountability, are very robust so that the consumers are not caught in between a fintech partner and a bank saying, "Who's responsible for losing this money?"

But I do agree, that I think with robust accountability, record-keeping, and proper pass-through deposit insurance rules, I mean, you can do a fintech bank partnership that I think can work. So I'm not against a well-regulated arrangement like that.

Alan Kaplinsky:

Right. Okay. Well, one final question, and then we're going to have to wrap up our program today. With one of these entities under the GENIUS Act, be able to engage in activities like lending money?

Art Wilmarth:

Well, I think that's... Right, so there are two problems. One is, I think because of the reserve requirements, effectively, they won't be allowed to make loans. And so this will, I think, to the extent that deposits are pulled out of the banking system and go into the stablecoin system, it will be similar to the money market funds, which again, couldn't make loans to consumers or Main Street businesses. So you have a cutoff of credit to consumers and Main Street businesses, which I think is counterproductive.

The other thing I would say is that there's this provision lurking in there that says that the responsible stablecoin regulator can permit any other activities that the regulator thinks are appropriate. And I can just imagine all sorts of derivatives and other activities that could be very dangerous. We're already seeing a proliferation of derivatives in terms of ETFs, futures, options on crypto, which is unfortunately very similar to what happened with subprime mortgages, that it wasn't just the subprime mortgages, but you had these credit default swap, CDOs and everything piled on top so that you had a pyramid of bets that went wrong when the mortgages went wrong. I'm afraid we're headed down the same path with crypto if we don't wake up.

Alan Kaplinsky:

Yeah. Okay. Well, we've come to the end of our program, Art, and I really want to thank you again for taking the time and to once again appear in our program. And we are definitely going to be following this stablecoin legislation. And if this thing passes, we'll probably be doing an edition of podcasts, probably be doing a webinar on the topic, because it really is a very big deal. But thank you, Art.

Art Wilmarth:

Thank you, Alan. It's a pleasure to be with you again. Thanks so much.

Alan Kaplinsky:

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