A Market Approach to Regulating Stablecoins, the Future's Money

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Executive Summary

The cryptocurrency sector experienced its most successful year to date in 2021. Familiar digital assets Bitcoin and Ethereum hit record values, as the overall crypto market burst from $500 billion to almost $3 trillion. (It has since fallen to $1 trillion.) Innovations like Non-Fungible Tokens entered the limelight, and debates raged about core crypto tenets like decentralization. It was also the year when regulators panicked that the oncoming crypto wave might cast them aside. China banned cryptocurrencies, while Russia and India teeter between bans and onerous regulation. Many Western countries followed suit, pushing comprehensive regulatory frameworks and government-run crypto substitutes.

Lost in the frenzy were stablecoins. In 2021, these stable-value tokens came of age, as the eight largest stablecoins grew by 574 percent. Still, the current volume, which stood at around $162 billion as of December 30, 2021, is a small part of total financial, or even crypto, markets. As the Bank for International Settlements, the international forum of central banks, described in a November 2020 paper, stablecoins initially addressed the failure of Bitcoin and other cryptocurrencies to serve as an instrument of payment. People preferred a less volatile asset and familiar unit of account. Stablecoins bridged the gap between blockchain transactions and fiat currencies. Their use has greatly expanded in recent years.

U.S. dollar-pegged stablecoins alarm regulators, unnerve some policy makers, and offer hope to billions of people living under repressive regimes using fiat currencies that have been devalued at will by dictators and bureaucrats. Stablecoins with faulty designs may fail—as many products and businesses fail in a dynamic, competitive market—but others promise a sounder, safer store of value and familiar unit of account. Stablecoins could be the future's money, but their fate remains uncertain due to the vagaries of financial regulatory policy.

In the United States, the President's Working Group on Financial Markets and other high-level financial regulators have recommended a stifling federal regulatory framework. The European Central Bank seeks to discourage integrating stablecoins with existing payment systems. And the Bank for International Settlements and its related Financial Stability Board have pushed for burdensome global regulation. These moves embody a myopic view that prioritizes managing risks and curbing illegal activity—real or imagined—over the benefits that stablecoins can offer to the world.

Stablecoins' increasing popularity, despite recent failures, combined with governments' growing unease about losing control of monetary policy, means they have reached an inflection point. If they survive the regulatory onslaught, they may provide unimaginable benefits—but change will not come easy, and will face resistance from some global financial actors, from tinpot dictators to international bodies, that fear losing status.

Paradoxically, for the U.S., stablecoins offer the best—and perhaps only—way for the dollar to remain the world's reserve currency. Internet dollars add desired functionality and programmability to the greenback. Although a few rules could provide

boundaries and discourage fraud, a heavy-handed approach to stablecoins will kill its most promising innovations. Instead, policy makers should take a minimalist, free-market approach that reflects the diversity of business models and maximizes choice for stablecoin issuers and users alike.

This paper examines how stablecoins evolved from a convenience for crypto traders to a tool of individual empowerment and global prosperity. It analyzes regulatory concerns, proposed solutions, and proposes a three-part free market alternative.

U.S. policy makers are at a crossroads. They can follow authoritarian states by banning stablecoins and promoting knockoff government alternatives, or they can show true vision with a measured, market-oriented approach. This paper proposes a three-level, issuer-choice approach to ensure that innovators, rather than regulators, have maximum flexibility. It would also provide certainty for future stablecoin issuers looking to start a company in, or move to, the U.S.

U.S. dollar-pegged stablecoins can power the future Internet. They can provide passive income to low-income people and a lifeline to political dissidents. They can help maintain the dollar's status as the world's reserve currency, with all the benefits that accrue to Americans. But none of those benefits will be realized if they are banned or regulated out of existence by bureaucrats and authoritarian regimes who fear the attributes that make stablecoins so appealing. With a few simple rules, the U.S. could lead the way in Internet money by embracing private innovation, shunning government alternatives, and prioritizing human prosperity over imagined risks.

Introduction

The cryptocurrency sector experienced its most successful year to date in 2021. Familiar digital assets Bitcoin and Ethereum hit record values, as the overall crypto market grew from $500 billion to almost $3 trillion. (It has since fallen to $1 trillion.)[1] Innovations like Non-Fungible Tokens entered the limelight,[2] and debates raged about core crypto tenets like decentralization.[3] It was also the year when regulators panicked that the oncoming crypto wave may cast them aside. China banned cryptocurrencies,[4] while Russia[5] and India teeter between bans and onerous regulation.[6] Many Western have countries followed suit, pushing comprehensive regulatory frameworks and government-run crypto substitutes.[7]

Lost in the frenzy were stablecoins. In 2021, these stable-value tokens came of age,[8] as the eight largest stablecoins grew by 574 percent.[9] Still, the current volume, which stood at around $162 billion as of December 30, 2021, is a small part of total financial, or even crypto, markets.[10] As the Bank for International Settlements, the international forum of central banks, described in a November 2020 paper, stablecoins initially addressed the failure of Bitcoin and other cryptocurrencies to become widely adopted as an instrument of payment. People preferred a familiar unit of account. Stablecoins bridged the gap between blockchain transactions and fiat currencies.[11] Their use has greatly expanded in recent years.

U.S. dollar-pegged stablecoins alarm regulators, unnerve some policy makers, and offer hope to billions of people living under repressive regimes using fiat currencies that have been devalued at will by dictators and bureaucrats. Stablecoins with faulty designs may fail—as many products and businesses fail in a dynamic, competitive market—but others promise a sounder, safer store of value and familiar unit of account. Stablecoins could be the future's money, but their fate remains uncertain due to the vagaries of financial regulatory policy.

In the United States, the President's Working Group on Financial Markets (PWG) and other high-level financial regulators have recommended a stifling federal regulatory framework.[12] The European Central Bank seeks to discourage integrating stablecoins with existing payment systems.[13] And the Bank for International Settlements and its related Financial Stability Board (FSB) have pushed for suffocating global regulation.[14] These moves embody a myopic view that prioritizes managing risks and curbing illegal activity—real or imagined—over the benefits that stablecoins can offer to humanity.

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Stablecoins' increasing popularity, combined with governments' growing unease about losing control of monetary policy, means they have reached an inflection point.[15] If they survive the regulatory onslaught, they may provide unimaginable benefits—but change will not come easily, and will face resistance from some global financial actors, from tinpot dictators to international bodies, that fear losing status.

Paradoxically, for the U.S., stablecoins offer the best—and perhaps only—way for the dollar to remain the world's reserve currency. Internet dollars add desired functionality and programmability to the greenback. Although a few rules could provide boundaries and discourage fraud, a heavy-handed approach to stablecoins will likely kill its most promising innovations. Instead, policy makers should take a minimalist, free-market approach that reflects the diversity of business models and maximizes choice for stablecoin issuers and users alike.

This paper examines how stablecoins evolved from a convenience for crypto traders to a tool of individual empowerment and global prosperity. It analyzes regulatory concerns, proposed solutions, and proposes a three-part free market alternative.

U.S. policy makers are also at a crossroads. They can follow authoritarian states by banning stablecoins and promoting knockoff government alternatives, or they can show true vision with a measured, market-oriented approach. This paper proposes a three-level, issuer-choice approach to ensure that innovators, rather than regulators, have maximum flexibility. It would also provide certainty for future stablecoin issuers looking to start a company in, or move to, the U.S.

Evolution of Stablecoins

The Congressional Research Service defines stablecoins as "a type of digital asset generally designed to maintain a stable value by linking its value to a national currency or other reference asset."[16] Stablecoins' peg to a hard asset helps them avoid the volatility that characterizes other digital assets. The U.S. dollar, the world's reserve currency, is the most popular stablecoin peg by far. Only three of the top 20 stablecoins peg to a different asset.[17]

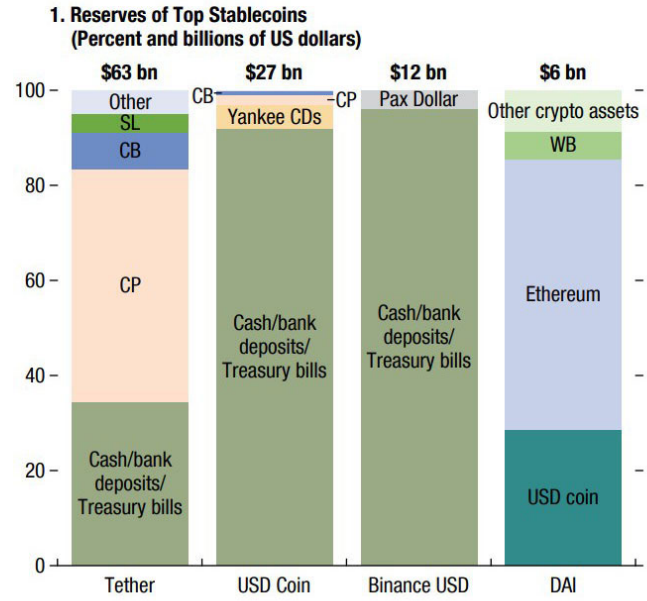
Stablecoins maintain their peg by either asset or algorithmic backing. The latter category is a smaller subset of uncollateralized stablecoins that had avoided scrutiny, until recently.[18] This paper focuses on asset-backed, dollar-pegged stablecoins.

Stablecoin issuers face the design challenge of simultaneously promoting use and yielding profits while maintaining market confidence in peg integrity. As prominent FinTech lawyer Jai Massari explained in December 2021 written testimony submitted to the Senate Banking, Housing, and Urban Affairs Committee:

> A well-designed stablecoin typically holds its value through a pair of promises. First, the stablecoin issuer agrees to sell and buy them back at par value (perhaps for a fee). Second, the issuer agrees to hold a pool of safe assets—the "reserve"—that has an aggregate market value at least equal to 100% of the aggregate par value of the stablecoins. Such a reserve is designed to back the issuer's obligation to repurchase stablecoins at par, and is replenished with the proceeds of stablecoin sales.[19]

There is diversity of both asset holdings and redemption rights among asset-backed stablecoins. Off-chain stablecoins, which hold traditional financial assets unattached to a blockchain—like Tether (trading symbol USDT), Circle (USDC), Paxos (USDP), and Binance (BUSD)—maintain collateralized reserves in financial institutions. These reserves vary from highly liquid cash and short-term government securities to less liquid, riskier instruments like commercial paper, corporate bonds, and other digital assets. On-chain stablecoin reserves stay on the blockchain. For example, MakerDAO's dollar-pegged stablecoin, DAI, is

Figure 1: Stablecoins vary considerably with respect to their reserve composition



International Monetary Fund, Global Financial Stability Report, October 2021, https://www.imf.org/-/media/Files/Publications/GFSR/2021/October/English/ch2.ashx.

Stablecoins can help impoverished people around the world safeguard savings against repressive and corrupt regimes and help dissidents escape political oppression.

collateralized largely by Ether, the native currency of the Ethereum blockchain.[20] Stablecoin redemption rights vary by eligible redeemers, fees, and limits.[21]

Tether, the first stablecoin, launched in 2014.[22] It is the largest stablecoin and fourth largest digital asset, with a current global market capitalization of over $78 billion.[23] Others emerged as interest in crypto trading grew in 2017.

Stablecoins provide myriad benefits. They can help impoverished people around the world safeguard savings against repressive and corrupt regimes and help dissidents escape political oppression. They can help fuel every imaginable type of human interaction and empower content creators to better profit from the work by enabling them to bypass intermediaries.

Functionally, stablecoins are next generation, globally accessible crypto dollars. They can be programmed, divided into fractional units, and transferred instantly between digital wallets outside the traditional banking system.[24]

Crypto Trading

Currently, stablecoins facilitate the seamless functioning of the continuous and complex web of crypto trading, lending, borrowing, and leveraging. Stablecoins enable these transactions without either transacting through traditional financial institutions or conversion into fiat currency. As a December 2021 House of Representatives Majority Staff report points out:

> Although stablecoins represent a relatively small fraction (5%) of the digital asset industry's total value, they facilitate more than 75% of trading on all digital asset trading platforms as of October 31, 2021.[25]

By one estimate, 80 percent of Bitcoin trades have Tether on one side.[26] During times of high volatility, stablecoins provide an easily accessible safe-haven asset. They also enable short-lived arbitrage opportunities, instant settlement of cross-border payments, and bilateral over-the-counter trades. They generated $1 trillion in transaction volume per quarter in 2021, according to an October 2021 McKinsey and Company report.[27] Utility makes stablecoins high-level velocity assets with a functional value well beyond their par value.[28]

Part of stablecoins' trading volume comes via the decentralized finance (DeFi) crypto sector, which allows users to trade and complete other economic transactions without centralized intermediaries. Open-source code creates rules and self-executing smart contracts settle deals. This innovation and some wellpublicized "rug pull" scams—in which bad actors posing as legitimate cryptocurrency developers attract investors and then pull out, leaving investors with nothing—have made DeFi a target for regulators,[29] academics,[30] and global bodies[31] trying to push DeFi activity back into the heavily regulated financial industry.[32]

People anywhere can profit from stablecoins without ever actively trading crypto. Because of their value in the crypto ecosystem, digital asset marketplaces pay extraordinarily high yields to those lending or "staking" stablecoins. While the average annual percentage yield for a savings account in the United States is 0.6 percent, that same money converted to a stablecoin and lent to a trading platform can yield 8 percent APY or higher.[33] Two examples of crypto marketplaces that pay these yields are Nexo[34] and Celsius.[35]

Unfortunately, this success has drawn scrutiny from regulators and politicians seeking to brand themselves protectors of consumers. In October, New York Attorney General Letitia James sent cease-and-desist letters to Nexo and Celsius,[36] even though Nexo claims to have installed geo-tracking software to bar New Yorkers.[37] Regardless, the Empire State has foreclosed its poorer residents from earning easy passive income at a time when inflation is exacting a massive hidden tax on essential purchases.[38] At the federal level, in February the Securities and Exchange Commission (SEC) announced a $100 million settlement with virtual exchange BlockFi, which has caused it to halt accepting new interest-bearing accounts, at least temporarily.[39] In April 2022, Celsius settled with the SEC, agreeing to limit its Earn financial product, which was originally open to everyone, to accredited investors.[40] Celsius, facing severe market stress, recently halted withdrawals and filed for Chapter 11 bankruptcy in July.[41]

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Payment Systems

Although they are still in their nascent stage, stablecoins have begun integrating into traditional payments. That has enormous potential benefits for the poor. As the International Monetary Fund points out: "The strength of stablecoins is their attractiveness as a means of payment. Low costs, global reach, and speed are all huge potential benefits."[42]

Stablecoins are decoupling payment services from credit services, offering increased competition and consumer benefit.[43] In an October 2021 letter to Treasury Secretary Janet Yellen, SEC Chair Gary Gensler, Fed Chair Jerome Powell, and Commodity Futures Trading Commission (CFTC) Acting Chair Rostin Behnam, Chamber of Digital Commerce Founder and

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President Perianne Boring and Chief Policy Officer Teana Baker-Taylor note that "traditional payments infrastructure is rife with fees given its over reliance on intermediaries."[44] In a comment letter submitted to the Federal Reserve Board of Governors in December 2018, Brookings Institution Senior Fellow in Economic Studies Aaron Klein estimated $3.4 billion in savings could occur by eliminating payday loans, check cashing services, and bank overdraft fees.[45] Stablecoins can disrupt these industries.

Stablecoins also provide cross-border payment benefits. The Chamber of Digital Commerce highlighted a study that showed stablecoin-backed cross-border payments typically cost between 0.5 percent and 1 percent of the transmission amount. This compares to 6.5 percent in the current archaic system and a fraction of the World Bank's Sustainable Development Goal of 3 percent.[46]

Stablecoins Can Help Power Web3

Stablecoins' programmability, their potential in micropayments, and other features allow them to fuel the transition to the Internet's next iteration colloquially known as Web3. As former Acting Comptroller of the Currency Brian Brooks stated in December 2021 testimony before the House Financial Services Committee:

> The way that Web3 solves a lot of problems is really two-fold. First of all, it eliminates the toll collector role of traditional banks and traditional broker dealers. The main thing that they do is they employ large numbers of human beings maintaining ledgers of account and allocating credit for a fee. ... [I]t [also] unlocks value that the traditional economic structures don't unlock.[47]

The individual-centered Web3 creator economy will run on programmable money, micropayments, smart contracts, and automation providing limitless and currently nonexistent passive income streams and wealth creation opportunities. As Tobias Adrian and Tommaso Mancini-Griffoli of the International Monetary Fund note:

> [T]he strongest attraction comes from the networks that promise to make transacting as easy as using social media. Payments are more than the mere act of transferring money. They are a fundamentally social experience linking people. Stablecoins offer the potential for better integration into our digital lives and are designed by firms that thrive on user-centric design.[48]

Circle's Chief Strategy Officer and Head of Global Policy Dante Disparte imagines a freelance journalist receiving a micropayment for every "like" his or her story gets.[49] Content creators who find YouTube's algorithm, frequently changing terms of service, and high fees too burdensome and expensive can receive the full value of their work.[50] But it is not only creatives who will benefit. People could receive passive income from lending out excess computer storage space overnight or renting parking spaces in urban areas. Stablecoins offer Web3 users instant settlement and a familiar unit of account. The possibilities are limitless.

Maintaining the Dollar's Status as the World's Reserve Currency and Spreading Freedom around the World

Whether through earning yield from a digital-asset trading platform, sending a cross-border payment, or receiving a micropayment, dollar-pegged stablecoins provide value around the world and help maintain the dollar's status as the world's reserve currency. As Paxos CEO and co-founder Charles Cascarilla testified in December 2021 before the House Financial Services Committee:

> Everywhere in the world, people want a U.S. bank account. And actually, that's the hardest thing to get. And crypto is a tool for a lot of different things, including bringing communities together, but what people want in order for their everyday spending is dollars. If you're in Argentina, you want dollars; if you're somebody anywhere in the world, you want to have access to dollars, and that's the hardest thing to get access to right now. And that's why tokenized dollars are so valuable because you don't need to have a bank account, yet you can have access to the dollar-based system. It's a very, very important tool for inclusion.[51]

Stablecoins come at a crucial time in the dollar's history, as it has lost ground to other currencies. In 2020 central bank dollar holdings fell below 60 percent for the first time in over 20 years.[52] Dollar-pegged stablecoins represent the best—and perhaps only—way to reverse that trend by adding functionality to the dollar's traditional appeal. As more competitors, including countries with authoritarian governments like China, enter the race for global reserve status, programmability of dollars can help the U.S. maintain its current status as the world's reserve currency. As Brian Brooks recently testified in Congress:

> [W]ith the rise of China and other major economies the U.S. dollar can't take its primacy for granted and we need to start thinking about competing on utility, on features, not just based on a post-World War II monetary

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> system that we could take for granted for the last two generations. And that's one of the reasons I've been such a supporter of Internet-enabled dollars, which allow us to compete on features not only on history.[53]

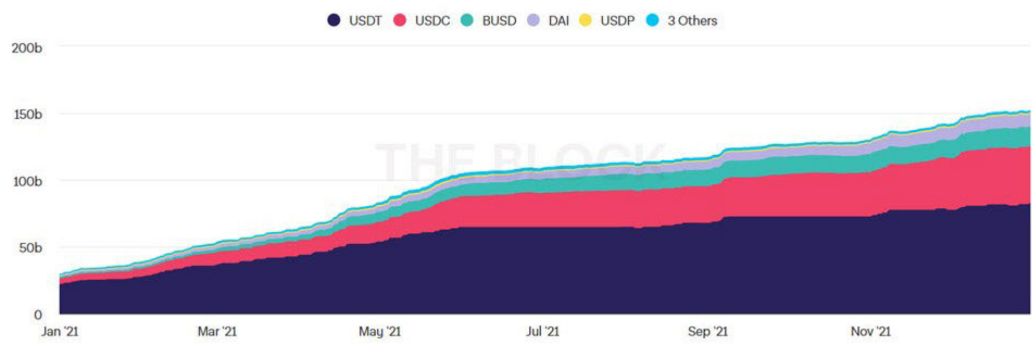
Fueled by familiarity and functionality, global demand for stablecoins is booming and will only increase. Increased adoption of blockchain technology will include billions of people over the next two to three years.[54] Stablecoins will likely help bring about that adoption. The stablecoin giant Tether is already used worldwide, and Circle began a global rollout in 2019.[55] This gives the U.S. a comparative advantage to define the future's money. As Circle co-founder, Chairman, and CEO Jeremy Allaire testified in December 2021 before the House Financial Services Committee:

> The United States ... is winning the digital currency space race. Today, dollar stablecoins are doing trillions of dollars of transactions. The experimental beta of a Chinese yuan, which is government-controlled in China, has done $10 billion of transactions. So, the United States is winning. This has the potential to grow at a very significant speed around the world and benefit the U.S. dollar and benefit American businesses and households.[56]

Stablecoins could usher in a new era of dollarization known as "crypto dollarization," since they offer an easier way to access the U.S. dollar's comparative stability, superior value, and broad acceptance.

Dollarization, which is particularly common in Latin America, refers to countries outsourcing monetary policy

Figure 2: Total Stablecoin Supply



Source: The Block, https://www.theblockcrypto.com/data/decentralized-finance/stablecoins.

to the U.S. This happens either through bottom-up market forces or by governments surrendering governments' monetary policy as citizens force their hand by using alternative currencies, either crypto or strong national currencies like the U.S. dollar. Countries that dollarize rank better on economist Steve Hanke's "Misery Index."[57] As Hanke points out, dollarization imports property rights and rule of law into poorly governed countries and prevents arbitrary devaluation.[58] As Hanke states:

> When stripped of all its technicalities, the money—rule of law nexus is nothing more than a matter of property rights. If a government is in possession of a devaluation option, those who own money issued by the government face the prospect of having their property rights confiscated in an arbitrary, ad hoc manner via devaluations.[59]

Dollar-pegged stablecoins act as bearer assets similar to cash that people can transfer across blockchains via private digital wallets. Crypto dollarization could come without the confiscatory government policies previous dollarization eras had.[60] As crypto columnist Nic Carter notes, "Money doesn't just possess network effects, money is a network."[61] [62]

Stablecoins' utility and global reach is evident in their transaction velocity. Tether changes hands 44 times annually compared to five for Bitcoin, 6.2 for Ether, and 5.5 for M1[63] U.S. money stock.[64] This velocity helps to get money quickly to people who need it most—not for savings, but for survival. That can provide needed help for people living under repressive regimes.[65]

Startups are providing stablecoins to the poorest people even when their countries ban it.[66] LocalBitcoins is a crypto infrastructure tool that allows global currency conversion. Venezuelans often use LocalBitcoins not to invest or hold Bitcoin, but as a backdoor to access stablecoins.[67] Stablecoins offered, and still may offer, a way to transact outside the tyranny and surveillance of the existing Chinese payment infrastructure like AliPay or the digital yuan that China has forced onto its citizenry. Before China banned privately issued cryptocurrencies, Chainalysis reported that Tether stablecoins were very popular in East Asia, including in China, surpassing even Bitcoin.[68]

More recently, Russia's invasion of Ukraine has solidified stablecoins' status as the go-to store of value for desperate citizens suddenly cast into crisis. When the invasion began, Tether became so popular among Ukrainians that it was trading at a premium of up to $1.10.[69] As the owner of one Ukrainian exchange told CoinDesk:

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> The majority of people have nothing else to choose apart from crypto. We're talking about millions of dollars of cash that wants to go into crypto … but we can't find people who are willing to do the opposite, sell it.[70]

Similarly, ordinary Russians began transferring wealth into stablecoins, while assertions that crypto would provide the Russian government and targeted oligarchs an escape hatch from sanctions have proved overblown.[71] As *Politico* reported in February 2022:

> Treasury officials say they aren't overly worried about crypto undermining the effort to choke off the Kremlin's access to capital. Laundering large amounts of money through a dizzying array of digital wallets and exchanges is expensive, time-consuming, and would likely be visible in the broader crypto market, given the massive investment portfolios of individuals and institutions named in the sanctions.[72]

Clearly, stablecoins are fueling the U.S. lead in the race for the future's money. But that will only last if the dollar remains an attractive store of value and medium of exchange. This hinges not on stablecoins' appeal, but on U.S. monetary and regulatory policy.

Monetary Policy

Open competition and the U.S. dollar's relative stability has helped secure its global status for decades. Given that history and clout, only misguided monetary or regulatory policy can prevent the dollar from becoming the Internet's reserve currency. If the U.S. devalues the dollar, market forces will find alternatives—as has always happened throughout history. In fact, investor Stan Druckenmiller warned in May 2021 that profligacy may cause the U.S. to lose its global reserve status within 15 years.[73] Those concerns are not outlandish. As former Heritage Foundation and current Cato Institute scholar Norbert Michel stated in 2018 testimony before the House Financial Services Committee's Subcommittee on Monetary Policy and Trade:

> It is certainly difficult to imagine a cryptocurrency replacing the U.S. dollar as long as the Federal Reserve acts as a moderately good steward of the national currency, but it is for this very reason that Congress should eliminate barriers that impede people from using their preferred medium of exchange.[74]

Ironically, as Brian Brooks noted in his December 2021 testimony, open currency competition with crypto could help rein in the Federal Reserve's most destructive present practices:

> One of the benefits of the crypto economy is that it creates some counter incentives on the part of the Fed to do that kind of policy because people will flee to other kinds of assets. And that sort of market competition is something that I think will ultimately shore up our monetary policy and keep the dollar ultimately where it ought to be, which is as the dominant reserve currency it's been for all of our lives.[75]

Regulatory Policy

The second threat is the prospect of government hamstringing flexibility and innovation by banning or forcing stablecoins under an onerous regulatory regime—purportedly to mitigate risks and fight illegal activity, real or imagined. Some government officials, like former Federal Reserve Board Vice Chair for Supervision Randal Quarles, have recognized the competitive advantages stablecoins provide:

> I believe that we must take strong account of the potential benefits of stablecoins, including the possibility that a U.S. dollar stablecoin might *support* the role of the dollar in the global economy.[76] [Emphasis in original]

However, Quarles's view is an outlier. Currently, crypto detractors prevail at federal agencies and standard-setting global bodies. They seek to

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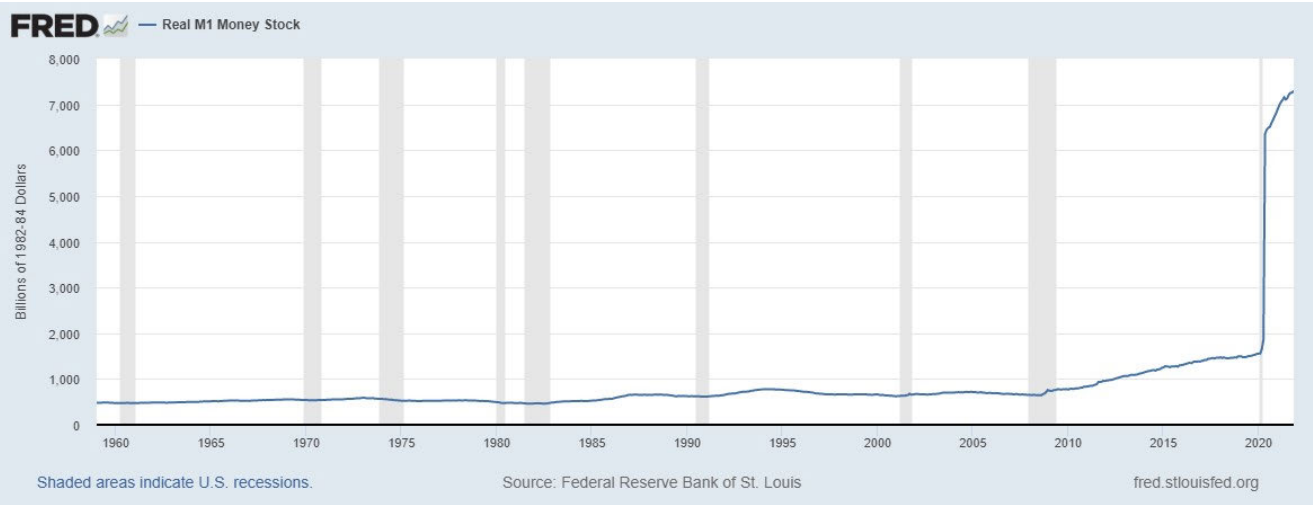
Figure 3: Real M1 Money Stock



Source: Federal Reserve Bank of St. Louis, https://fred.stlouisfed.org/series/M1REAL/.

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quash or regulate away stablecoins with government alternatives—namely central bank digital currencies (CBDCs). These proposed substitutes will not offer stablecoins' flexibility, programmability, or compatibility with Web3 composablity—the ability of software developers to create new products from different software components. This is an essential element of Web3.[77] Instead, they will come laden with granular monitoring akin, if lesser in degree, to the now-functional digital yuan.[78]

CBDCs come with none of the benefits stablecoins provide in decentralization, cash-like properties, and at least some protection from intrusive monitoring under Anti-Money Laundering/ Countering Terrorist Financing (AML/CFT) regulations. They are state instruments that are monitored, controlled, and recorded by the central banking authority at all times. At their worst, they can be incorporated into a social credit system and used for economic control, as is happening in China.[79] But even in democratic Western countries, they can lead to invasive monitoring of all financial transactions and citizens' financial decisions.

Detractors fail to recognize stablecoins' benefits, believe that their use harms U.S. interests, or both. Sen. Sherrod Brown (D-OH), a prominent crypto critic, wants direct Federal Reserve accounts for CBDCs and a ban on, or heavy regulation of, private alternatives. In March 2021, he wrote to Fed Chair Powell and Fed Governor Lael Brainard, stating that the Fed "must lead the way on CBDCs and other digital payments, just as the Federal Reserve has done in moving forward with its faster payments system, FedNow. ... We cannot be left behind."[80] Sen. Elizabeth Warren (D-MA) warned in July 2021: "Our regulators need to get serious about clamping down on [stablecoin] risks before it's too late."[81] She had previously described crypto markets as run by "the whims of some shadowy faceless group of super coders and miners."[82] And Rep. Brad Sherman (D-CA), another major crypto critic, said at a 2019 House Financial Services Committee hearing:

> Cryptocurrency either doesn't work, in which case investors lose a lot of money, or it does achieve its objectives perhaps and displaces the U.S. dollar, or interferes with the U.S. dollar being the sole reserve currency, or virtually the sole reserve currency in the world.[83]

Political pressure has likely influenced financial regulators. Securities and Exchange Commission Chair Gary Gensler, also a crypto critic, stated in August 2021: "[T]he use of stablecoins

... may facilitate those seeking to sidestep a host of public policy goals connected to our traditional banking and financial system."[84] Brainard has questioned stablecoin legality and the "appropriate role of private money," while pushing public options.[85] Powell was more forthright:

> I think that's one of the arguments that are offered in favor of digital currency… That, in particular, you wouldn't need stablecoins, you wouldn't need cryptocurrencies if you had a digital U.S. currency—I think that's one of the stronger arguments in its favor.[86]

A stablecoin ban and widespread CBDC adoption would produce a softer version of the dystopian nightmare China is implementing and others are considering. A CBDC with strict AML/CFT monitoring or reporting requirements might thwart some illegal activity, even though bad actors might simply continue transacting in cash or other less traceable substitutes. It may also fine-tune monetary policy, but it threatens government overreach and encroachment upon private citizens, by potentially creating an environment in which limits on state power and checks on the central monetary authority are absent. In his 2018 testimony, Norbert Michel explained such a scenario:

> The main idea behind improving the central bank's ability to conduct monetary policy is simple: prevent people from escaping government-imposed fees on their idle money balances. In other words, force everyone to have retail accounts at a central bank—and eliminate the use of any other form of money—so that people are left with no way to stop the government from imposing taxes to induce more spending. If, for example, the Fed decided that aggregate spending was too low, the central bank could threaten to take individuals' money as a way to incentivize more spending. ... This extreme policy—a complete government monopoly of money—would leave all people wholly dependent on a government-controlled electronic network for conducting all transactions. It would endanger law-abiding citizens' privacy and subject them to the whims of both elected and unelected government officials.[87]

Even the less aggressive approach of heavily regulating stablecoins, as many current proposals advocate, would undermine many of their benefits, and could have devastating unintended consequences. Specifically, it would undermine

A stablecoin ban and widespread CBDC adoption would produce a softer version of the dystopian nightmare China is implementing.

The level of privacy stablecoins provide gives people living under oppressive regimes some protection against government surveillance.

stablecoins' utility and flexibility, while subjecting them to burdensome and intrusive banking regulations. Governments' unceasing AML/CFT concerns always justify granular monitoring. Regulators,[88] academics,[89] and commentators also warn of systemic risks that require comprehensive and international solutions.[90]

The President's Working Group (PWG) report, released in November 2021, leads the current push.[91] It warns of myriad stablecoin risks and urges Congress to pass legislation requiring issuers to become insured depository institutions—federally chartered banks—and ban alternatives.[92] If Congress were to decline to pass such legislation, the PWG supports unilateral action via the Financial Stability Oversight Council (FSOC)—established within the Treasury Department by the Dodd-Frank Act of 2010—to declare stablecoins "systemically important," which would give regulators free rein to impose rules.[93]

Illegal Activity

A major concern of both the President's Working Group and the Financial Stability Board is compliance with Anti-Money Laundering/Countering Terrorist Financing regulations. Whatever justification these laws may have to cover other types of payments and money transfers—and there may be no justification—the concerns dissipate for stablecoins given their public and traceability attributes.[94] The PWG claims that "mass adoption of a well-regulated and supervised stablecoin with strong AML/CFT protections built into the stablecoin could provide greater transparency into illicit financial activity and could mitigate ML/TF risks."[95] Yet, criminals would likely stop using blockchain-based transfers in favor of more anonymous transfer methods, including cash.

Furthermore, the level of privacy stablecoins do provide gives people living under oppressive regimes some protection against government surveillance. As Nic Carter notes:

> Crypto-dollarization works because stablecoins are, for the most part, unencumbered by the shackles of the U.S. banking system. ... By granting a measure of transactional privacy and not embedding political conditions into transactions, stablecoins are the closest thing to digital cash we have today.[96]

Some level of AML/CFT monitoring may be necessary for legitimate law enforcement purposes, but such laws are clearly vulnerable to abuse and privacy concerns.[97] Regardless, policy makers need to evaluate their effectiveness for enabling blockchain transfers and potential for abuse.

Other Risks

The number and magnitude of stablecoin risks cited in the PWG report is far out of proportion for this miniscule market. In fact, the word "risk" appears 131 times in the 26-page document, covering the following topics:

- Market integrity;
- Investor protection, encompassing possible fraud and misconduct in digital asset trading, including market manipulation, insider trading, front running, and a lack of trading or price transparency;
- Illicit finance and financial integrity, including concerns related to compliance with AML/CFT rules;
- Systemic risks, including concentrations of economic power;
- Settlement risks;
- Liquidity risks;
- Prudential risks, including stablecoin runs and payment system risks;
- Risks pertaining to trading platforms and DeFi; and
- Operational risks related to cybersecurity and the collection, storage, and safeguarding of data.

The PWG believes these risks "have the potential to manifest in novel ways,"[98] and that supposed "regulatory gaps" can only be patched with a "federal prudential framework on a consistent and comprehensive basis."[99] The PWG has pledged to cooperate with various international financial regulatory bodies to ensure "comprehensive oversight of stablecoin arrangements,"[100] all focused to varying degrees on AML/CFT rules, though consensus has proved difficult.[101]

Regulation would undermine many of stablecoins' most attractive features.

Proposed Stablecoin Regulatory Frameworks Will Not Work

As detailed below, federal and international stablecoin regulation would undermine many of stablecoins' most attractive features and impose rules unsuitable to issuer business models. Furthermore, the purported risks that proposed regulation seeks to address are overblown and unlikely to materialize. Moreover, regulations are likely to entail blanket solutions that are not narrowly tailored to address any supposed specific ills.

Forcing stablecoin issuers to receive federal bank charters comes with risks that the PWG and FSB do not adequately address.

To start with, the PWG proposes to spread regulatory authority across several agencies, a scenario that would

Vast discretion by regulators would impede companies' ability to build useful products.

lead to confusion and harm stablecoins' growth. In general, lack of clarity has long beset federal crypto policy. For years, industry participants have asked the federal government to provide clear rules on when digital assets are securities, only to be stonewalled, ignored, sued, or told to take their chances. As former acting Comptroller of the Currency Brian Brooks noted in his December 2021 testimony:

> What happens in the United States is you have a new crypto project and you walk into the SEC and you describe it in great detail and you ask for guidance and they say we can't tell you and you list it at your own peril.[102]

Prominent law firm Jones Day points out that a common complaint among crypto practitioners is that the lack of guidance from the SEC is compounded by regulatory and judicial treatment of ambiguous concepts like "security" and "financial institution."[103]

The President's Working Group report suggests that stablecoin arrangements and digital-asset trading may come under the jurisdiction of the SEC, CFTC, or both.[104] In July 2021 remarks before the American Bar Association, SEC Chair Gensler suggested that stablecoins should fall under SEC jurisdiction, despite the lack of profit expectation that would seemingly preclude SEC jurisdiction.[105]

The PWG suggests that other federal agencies would also have some regulatory jurisdiction over stablecoins, including the Department of Justice, Consumer Financial Protection Bureau, Financial Crimes Enforcement Network (FinCEN) and the Financial Oversight Stability Council. The PWG calls for tasking these agencies with enforcing numerous federal laws, including the Glass-Steagall Act, Electronic Fund Transfer Act, Gramm-Leach-Bliley Act, Consumer Financial Protection Act, and Bank Secrecy Act.[106]

Regulators often stress that they need flexibility to evaluate each issuer or action under distinct "facts and circumstances."[107] As the PWG report states:

> Because payment stablecoins are an emerging and rapidly developing type of financial instrument, legislation should provide regulators flexibility to respond to future developments and adequately address risks across a variety of organizational structures.[108]

However, vast discretion by regulators would impede companies' ability to build useful products. Ambiguity injects uncertainty, while entire industries suffer as basic questions take years to resolve through enforcement actions.[109] Specifically for crypto, federal regulators have botched guidance from the start.[110] SEC Chair Gensler has exacerbated regulatory uncertainty, with a strident "enforcement-only" policy encapsulated in a November 2021 speech, in which he brushed aside concerns of using the weight of the federal government to pursue what many consider confusing guidance, "Some market participants may call [my approach] 'regulation by enforcement.' I just call it 'enforcement.'"[111] Crypto investor Katherine Wu, called the speech "the most aggressive and hostile stance re US crypto regulation to date from the SEC."[112]

Given all this discretion, it is unsurprising for regulators to see risks everywhere. Yet, such concerns about stablecoins' risks are overblown. Stablecoins are a small, though growing, segment of the broader financial market. Although the number constantly fluctuates, the total stablecoin market cap at the end of 2021 stood at $162 billion. Compare that to the total value of dollars ($2 trillion), outstanding Treasury notes ($5.4 trillion), money market funds ($4.5 trillion), and equities ($40.7 trillion).[113] Tether's market value equals roughly 3 percent of JPMorgan Chase's deposits.[114] The Chamber of Digital Commerce compares the stablecoin market to corporate gift reward programs. For example, Starbucks' prepaid rewards program alone would equal the sixth largest stablecoin.[115]

For crypto, federal regulators have botched guidance from the start.

Bypassing Congress and allowing FSOC to impose regulation without legislative input would be particularly unwise. The FSOC, which was created by the Dodd-Frank Act, has a shaky track record. Dodd-Frank gave the FSOC the authority to designate payment, clearing, or settlement activities that it determines are—or are likely to become—systemically important.[116] That discretion is very broad, since the U.S. Code does not define "financial stability." Still, no existing stablecoin even begins to approach meeting that designation. As Senate Banking Committee Ranking Member Patrick Toomey (R-PA) argued in an October 2021 letter to Treasury Secretary Janet Yellen:

> Not only would such a designation cause tremendous damage to an emerging technology, it would violate the statutory standard for designation since stablecoins do not pose a threat to the stability of the U.S. financial system.[117]

In fact, a court previously found an FSOC designation arbitrary and capricious.[118] Despite insurance giant's MetLife's protests that it was not "systemically important"—and its desire to have neither the regulatory burdens that come with such a designation nor the bailout benefits of being designated by the government as essentially "too big to fail"—the FSOC still designated the firm that way based on very little empirical data. Writing about the court ruling that overturned this designation, CEI Senior Fellow and Director of Finance Policy John Berlau concluded, "The ruling limits the government using its power arbitrarily to fit non-bank financial firms into the banking regulation hole."[119] Yet, the PWG advocates doing just that, by proposing that stablecoin issuers be placed under the FSOC's regulatory authority.

For comparison, the Clearing House Payments Company, currently classified as one of only eight systemically important financial market utilities, clears $1.8 trillion payments per day.[120] All stablecoins combined do only $1 trillion per quarter.[121] Tether, the largest stablecoin, had a total market value of just over $83 billion as of May 6, 2022.[122] The PWG report suggests that rapid scaling could occur via a major technology company's stablecoin, noting that, "In some cases, rapid scaling may be supported by access to existing customer bases and further enabled by access to end users' data."[123] It also suggests that Congress should ban these companies from issuing stablecoins.[124] In general, Congress should not limit competition and any regulatory designations should be specific to issuers and not envelop all current and future entrants. As the Chamber of Digital Commerce states:

> Ultimately, if regulators determine that certain stablecoin payments systems require federal regulation due to concerns over systemic risk, such regulation should only apply to individual stablecoin payments systems that are significant enough to generate systemic risk.[125]

Instead of lessening concentrations of economic power, the PWG's regulatory solution—to force all stablecoin issuers to become federally chartered banks and ban other models—would shift power from large stablecoin issuers, or large technology companies issuing stablecoins, to large banks, which are already dominant economic players.[126]

Unintended Consequences

If Congress or the FSOC were to follow the PWG's suggestions, it would invite a host of potential unintended consequences into the financial markets that would exceed any supposed risks posed by stablecoins. Commercial banks could experience upheaval. If stablecoin issuers were to become insured depository institutions, they would resemble "narrow banks"—banks that hold full reserves and do not engage in fractional reserve lending—or money market funds, depending on capital backing requirements, but not authorized to engage in fractional reserve lending. In a July 2021 paper, Yale Management Professor Gary Gorton and Fed economist Jeffery Zhang point out several problems that this could create for the current system. For example, stablecoin issuers that resemble narrow banks could balloon the Federal Reserve's balance sheet, which would make lending more difficult for traditional banks. The market for Treasury securities may become more expensive and less liquid. In times of economic stress, investors could focus on holding stablecoins instead of traditional options, further upending markets.[127]

Furthermore, becoming insured depository institutions that do not offer loans would not be feasible for most stablecoin issuers, although both Circle and Paxos have applied. In April 2021, the Office of the Comptroller of the Currency (OCC) conditionally granted a national bank trust charter to Paxos.[128] Circle has also signaled a desire for chartered-bank status.[129] But that option will not fit many issuers' business models and could dissuade new entrants and encourage market concentration. It is expensive to hold full reserves, as money sits idle, not earning anything. Commercial banks are subject to OCC-imposed leverage and risk-based capital ratios based on banks' riskier and less liquid holdings. Congress would have to adjust these ratios for stablecoin issuers' business models.[130] But even lower ratios would impose unnecessary barriers for smaller or new entrants.

Becoming insured depository institutions that do not offer loans would not be feasible for most stablecoin issuers.

A Free Market Approach to Stablecoin Regulation

As noted, a three-level, issuer-choice policy approach toward stablecoins will help ensure that innovators, rather than regulators, have maximum flexibility, and provide certainty for future stablecoin issuers looking to start a company in, or move to, the U.S.

Stablecoins, like any other financial instrument, need guardrails to ensure integrity and provide users with vital information. Congress could accomplish this via simple, straightforward disclosures rules, enacted through an optional federal money transmission-type license. Through this light disclosure regime, the U.S. and the rest of the world could enjoy the benefits of the future's money, ensure the dollar's global dominance, and isolate regimes that limit financial freedom.

In the U.S., these disclosures could focus on two issues where problems, to the extent they have existed, have arisen, while giving issuers and consumers the freedom to assess their own risk tolerance regarding status of reserves and redemption rights. It would make the regulation straightforward, removing a hodgepodge of state and federal agencies, each seeking to protect its turf. It would also allow the two other currently available options for issuers and define stablecoins as non-securities to unequivocally bar SEC jurisdiction.

To illustrate, consider a recent case in which Tether allegedly misstated its reserves. In February 2021, New York Attorney General Letitia James settled with Tether and related exchange Bifinex. Tether paid an $18.5 million fine for allegedly misstating its reserves.[131] Other regulatory agencies, smelling blood, pounced. In October 2021, the Commodity Futures Trading Commission fined Tether $41 million.[132] The SEC may also now be in pursuit.[133]

While no one lost a dime because of Tether's alleged wrongdoing, the settlements provide fodder for ambitious officials seeking name recognition and career advancement, and gives bureaucrats an excuse to promote the costly and burdensome regulatory measures now being proposed. Yet, a few simple disclosure rules would have prevented Tether's alleged infractions and removed a source of regulatory ammunition now aimed at the industry.

There is broad agreement among policy makers that disclosure of reserves and redemption rights should inform any regulatory framework, although most proposals would go much further. These two parts of the stablecoin business help bolster market confidence. As Norbert Michel states, lack of reserve transparency prevents a proper evaluation of issuer integrity."[134] Sen. Pat Toomey adds:

> All stablecoin issuers should have to adopt clear redemption policies, disclosure requirements regarding the assets backing the stablecoin, and potentially meet liquidity and asset quality requirements.[135]

Disclosing redemption policies and reserve assets, without dictating content, allows the market to judge each issuer's credibility and integrity. It also allows innovation to flourish, as stablecoin issuers are spared from a federal regulatory regime meant for traditional banks. And it is good business practice, as redemption policies can be found online, while most major issuers already post reserves on various schedules.[136] For example, a December 2021 report of the Democratic majority of the House Financial Services Committee detailed how DAI collateralization had surpassed 200 percent, and that Circle

Table 1: Stablecoins, Redemptions, and Fiat Money as of June 30, 2021

Name	How to redeem it?	Is there a cost to redeem?	Is there a notice period?	How are the underlying assets custodied?
Tether	Submit request through Tether account. Tether is available to redeem in the US in all states except New York.	Yes. Fiat withdrawal fee: the greater of $1,000 or 0.1% of amount withdrawn. Account verification fee: $150 in Tether tokens.	No. However, there may be an initial delay because Tether accounts need to be verified before redemption can occur. Verification can take days to weeks.	Deltec Bank & Trust (Tether's bank partner in the Bahamas).
USDC	1. Request redemption from issuer (minimum 100 USDC). 2. Once verified and validated, USDC tokens are "burned" (deleted from circulation). 3. Funds from underlying reserves are transferred to customer's external bank.	No. However, user's bank may charge fees when receiving the funds.	No. However, there is a verification period which may delay the time between requesting redemption and receiving the USD.	With licensed CENTRE token-issuing member (i.e., Circle).
TrueUSD	1. Input bank information into TrustToken app and receive unique redemption address. 2. Send TrueUSD (minimum $1,000) to unique redemption address. 3. TrueUSD deleted by smart contract, and banking partners issue a wire to user's bank account within 1 business day.	No. However, user may incur domestic wire fees of up to $30 and international wire fees of up to $100.	No.	Escrow accounts (through partnering with registered banks and fiduciaries). These partners include Alliance Trust Company of Nevada and Prime Trust (a trust company in Nevada). Banking relationships include U.S. Bank, Alliance Bank, and Mercantile Bank.
Paxos	1. Use Paxos account (which has unique redemption address). Send PAX to redemption address. 2. Paxos will credit account with USD (may take up to 1 business day).	No. However, user's bank or crypto asset wallet provider may charge transaction fees when receiving the funds.	No.	USD held in Paxos Trust Company in segregated custodial accounts with U.S. banks or invested in debt instruments of US government.
Gemini Dollar	Sell GUSD on Gemini platform, and USD will be credited to Gemini account balance at time of sale.	No.	No.	State Street Bank and Trust Company. More generally, U.S. banks, eligible for Federal Deposit Insurance Corporation ("FDIC") "pass-through" deposit insurance coverage.
EURSToken	N/A — cannot directly redeem from STASIS (its issuer) but can exchange for fiat euros through other institutions (Globitex, Exante).	N/A	N/A	Various partner institutions, including EXT Ltd (company licensed by Cyprus SEC), XNT Ltd (company licensed by MFSA, Malta), UAB NexPay (electronic money institution, authorized by Central Bank of Lithuania).
Stably USD, formerly StableUSD (USDS)	Redeem by generating a personalized deposit address and sending USDS to this deposit address (minimum $50). USD will be wired to the user's bank account.	No. However, user's bank may charge wire fees for receiving the funds.	No.	FDIC-insured escrow accounts managed by Prime Trust (a trust company in Nevada).
Stronghold USD	Redeem through Stronghold's user interface. User can initiate a withdrawal request and get USD through wire transfer or ACH payment, typically within the same day.	No. However, user's bank may charge fees.	No.	Reserves held in state-chartered trust company, Prime Trust (a trust company in Nevada). Prime Trust deposits the cash at FDIC-insured banks.

Sources: Gary B Gorton, Gary B. and Jeffery Zhang, Jeffery, "Taming Wildcat Stablecoins," University of Chicago Law Review, Vol. 90, September 30, 2021, https://ssrn.com/abstract=3888752.

Federalism is an important component of the U.S. constitutional structure that should guide the stablecoin regulatory framework.

and Paxos were also overcollateralized.[137] Furthermore, Circle announced that as of September 2021, 100 percent of the USD Coin would consist of cash or cash equivalents. Tether is an outlier, holding relatively riskier commercial paper and corporate bonds.[138] Yet, Tether recently slashed its commercial paper holdings.[139] Many of these issuers have third-party accounting firms attest to their reserve integrity.[140]

In their study, Gorton and Zhang published redemption policies of the major stablecoin issuers, outlined in Table 1.[141]

The President's Working Group reports frets about the lack of standardized reserve assets, noting: "These stablecoins are often advertised as being supported or backed by a variety of 'reserve assets.' However, there are no standards regarding the composition of stablecoin reserve assets."[142] But there should not be. As long as issuers disclose reserve assets, the public and the virtual exchanges—which have an interest in stablecoin integrity, given their import in trading—can evaluate risk. Issuers with access to these two pieces of information should be able to compete on any scale.

Tripartite Approach

Federalism is an important component of the U.S. constitutional structure that should guide the stablecoin regulatory framework. The Competitive Enterprise Institute has long championed the optional federal charter approach as consistent with the U.S. system of "competitive federalism" envisioned by the Constitution's framers. As George Mason University Law Professor and CEI board member Michael Greve has written, "Real federalism aims to provide citizens with choices among different sovereigns [and] regulatory regimes."[143]

In the past, CEI has advocated bolstering the option federal chartering system for banking regulation and applying it to regulation of insurance and small-dollar lending. A system of optional federal chartering is especially important for the frontier industry of stablecoins to check excessive regulation by either states or the federal government. As CEI's John Berlau notes, there has been a dearth in federal government approvals for any type of new, or "de novo," banks that began in the Obama administration.[144] The stablecoin industry must not be subject to this blocking of new entrants.

Building on other detailed proposals, this paper suggests stablecoin issuers select one of three regulatory options:

1. A federal money-transmission license with the disclosure requirements outlined above;

2. A state-level money transmission system with its federal obligations that comprise the status quo; or
3. A state or federal bank charter, the latter as proposed in the PWG report.

This three-tier proposal borrows both from Sen. Toomey's proposed stablecoin framework[145] and Coin Center Research Director Peter Van Valkenburgh's in-depth analysis of state money-transmission laws.[146] Toomey proposes a three-tier option with a federal special-purpose banking charter designed for stablecoin issuers in accordance with new legislation.[147] Van Valkenburgh suggests a federal-only money transmission license as a possible option.[148]

Federal Money Transmission License Preempting States. The federal money transmission license would preempt state involvement and focus on disclosure of reserves and redemption policies. State preemption is crucial for Internet-based companies, as University of Arkansas Law Professor Carol Goforth explains:

> In the context of crypto, the need to comply with myriad state money transmitter requirements is proving to be particularly painful. The primary problem appears to be that crypto-based businesses are finding themselves subject to numerous requirements that were not designed with them in mind.[149]

The Treasury Department would issue and administer the license with a few simple rules. Specifically, Treasury would:

1. Preempt state money transmission laws.
2. Declare that stablecoins are not securities.
3. Require asset-backed stablecoin issuers to publish their reserves, any third-party verification, and redemption policies on their website at defined intervals. It would not direct the composition of reserves or any particular redemption policies, which the market will sort.

This has attributes of other proposals.

Van Valkenburgh proposes as one possible option an "alternative federal license" that acts similarly to state money transmission licenses but preempts state interference for those choosing that route.[150] Jai Massari proposes an "optional federal charter" that would tweak capital reserve requirements to account for the different business models between fractional reserve lending banks and stablecoin issuers.[151]

Norbert Michel and Jennifer J. Schulp of the Cato Institute propose a

Congress should not give the SEC the power to regulate the future's money.

somewhat similar approach focused on disclosure of reserves and regulated as a "limited purpose investment company." Their proposal would amend the Investment Company Act of 1940 and place stablecoins under the SEC's ambit.[152] However, the SEC's hostility toward crypto innovation has been evident for years, and has only increased under Gensler.[153]

In fact, any federal licensing law must define stablecoins as non-securities that do not implicate investment-contract analysis of the three-part *Howey* Test, which evaluates whether non-traditional instruments qualify as investment contracts and therefore should be regulated as securities.[154] Gensler's enforcement-only approach[155] has ensnared Circle[156] and possibly Tether[157] for investigation, in addition to the 55 enforcement actions the SEC has brought against digital-asset issuers.[158] Gensler has sought bigger budgets[159] and "plenary authority" to aid his quest against all things crypto.[160] In May 2022, the SEC nearly doubled the number of attorneys focused on crypto enforcement.[161] Congress should not give the SEC the power to regulate the future's money.

State-Level Money Transmission Licenses. Alternatively, stablecoin issuers could remain within the existing state-by-state money transmitter regime. This is suboptimal for many reasons, but it should still be an option. The U.S. regulatory system currently classifies stablecoins as "convertible virtual currency" regulated federally under FinCen[162] and state money transmission laws that arose haphazardly as a consumer protection against money-order fraud.[163] As Van Valkenburgh explains, they are ill-suited for national and international stablecoin markets with their global reach and lack of sufficient nexus to individual state regulatory regimes. He states: "State and local regulation was more sensible [previously] because these brick and mortar businesses were typically based in and only had customers in that state."[164]

Furthermore, state transmission laws create inefficiencies and negative externalities, as individual states have no incentive to account for other states' regimes.[165] For instance, New York has imposed onerous requirements for a variety of crypto activities through its Bitlicense, which can take four years,[166] $100,000 in legal fees,[167] and 1,000-page applications.[168] Conversely, Wyoming promotes a crypto friendly brand.[169] Meanwhile, some states still struggle to define crypto's basic terms.[170]

A state-by-state regime seems foolhardy, yet the Chamber of Digital Commerce advocates for this status quo, arguing, "Before attempting to develop a new regulatory regime, policymakers should first establish through a transparent and open process what gaps, if any, exist under the current approach."[171] However, it has called on states to "encourage the streamlining of state-level regulatory frameworks for stablecoins and the issuance of special-purpose charters by federal banking regulators for stablecoin companies seeking to operate nationally."[172] That seems unlikely. As Van Valkenburgh notes, "Only 12 states and territories have thus far adopted a uniform [money transmission] model law developed 18 years ago by the Uniform Law Commission, a non-governmental organization specializing in harmonizing state legislation."[173]

Option of Federal or State Bank Charter. Finally, stablecoin issuers can pursue state or federal bank charters and become insured depository institutions. As noted, this is the path two stablecoin issuers have chosen. Any others should be free to seek access to the Federal Reserve infrastructure, for whatever reason they choose, but it should be a choice, not a requirement.[174]

U.S. dollar-pegged stablecoins can power the future Internet.

Conclusion

U.S. dollar-pegged stablecoins can power the future Internet. They can provide passive income to low-income people and a lifeline to political dissidents. They can help maintain the dollar's status as the world's reserve currency, with all the benefits that accrues to Americans. But none of those benefits will be realized if they are banned or regulated out of existence by bureaucrats and authoritarian regimes who fear the attributes that make stablecoins so appealing. With a few simple rules, the U.S. could lead the way into Internet money by embracing private innovation, shunning government alternatives, and prioritizing human prosperity over imagined risks.

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3. Other liquid deposits, consisting of other checkable deposits, or OCDs, which comprise negotiable order of withdrawal, or NOW, and automatic transfer service, or ATS, accounts at depository institutions, share draft accounts at credit unions, and demand deposits at thrift institutions, and savings deposits, including money market deposit accounts.

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About the Author

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