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The Honorable Patrick McHenry
Chairman
House Financial Services Committee

The Honorable Maxine Waters
Ranking Member
House Financial Services Committee

Dear Chairman McHenry and Ranking Member Waters,

I write to express concerns about the risks that stablecoins pose to consumers, financial stability, and our national security. As your committee has recognized, stablecoins and stablecoin-related activities may undermine consumer protection and the safety and soundness of the banking system.[1] But efforts to create new regulatory frameworks around the $157 billion stablecoin market,[2] including those that aim to fold stablecoins deeper into the banking sector, could amplify and entrench these risks rather than mitigate them. I urge you to remember the gravity of these risks as your committee consider proposals to regulate stablecoins and avoid introducing stablecoin legislation that holds the potential of unleashing another financial crisis.[3]

Stablecoins are "a category of cryptocurrencies with mechanisms that are aimed at maintaining a stable value, such as by pegging the value of the coin to a specific currency, asset, or pool of assets"[4] and "offer a way for traders to quickly move between more volatile coins and something approximating cash or a way to hold or send money without using a bank."[5] While "[p]roponents believe stablecoins could become widely used by households and businesses as a means of payment,"[6] research from the Bank of International Settlements

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[1] House Financial Services Committee, "Hearing Entitled: Putting the 'Stable' in 'Stablecoins:' How Legislation Will Help Stablecoins Achieve Their Promise," May 18, 2023, https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=408790; House Financial Services Committee, "Hearing Entitled: Understanding Stablecoins' Role in Payments and the Need for Legislation," April 19, 2023, https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=408691.

[2] The Block, "USD Pegged," accessed April 2, 2024, https://www.theblock.co/data/stablecoins/usd-pegged.

[3] CoinDesk, "Key U.S. Lawmaker McHenry Says House Has 'Workable' Stablecoin Bill," Jesse Hamilton, March 20, 2024, https://www.coindesk.com/policy/2024/03/20/key-us-lawmaker-mchenry-says-house-has-workable-stablecoin-bill/.

[4] The White House, Executive Order No. 14067, "Ensuring Responsible Development of Digital Assets," March 9, 2022, https://www.federalregister.gov/documents/2022/03/14/2022-05471/ensuring-responsible-development-of-digital-assets.

[5] Bloomberg, "Why Crypto Stablecoins Still Worry the Fed," Olga Kharif and Yueqi Kang, February 10, 2024, https://www.bloomberg.com/news/articles/2024-02-10/why-stablecoins-such-as-tether-and-usdc-still-worry-the-fed.

[6] President's Working Group on Financial Markets (PWG), Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Report on Stablecoins," November 2021, p. 1, https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf.

"shows that, to date, stablecoins are seldom used for payments outside the crypto ecosystem."[7] Instead, stablecoins' main use has been to facilitate speculative trading in cryptocurrencies, particularly in decentralized finance (DeFi).[8]

Despite their limited use outside of the crypto world, stablecoins have become increasingly intertwined in our traditional financial system. In "one of the first instances of demonstrated contagion between crypto/traditional markets," USDC lost its 1:1 peg during the March 2023 banking crisis following the revelation that USDC's issuer, Circle, had $3.3 billion of cash reserves stuck at Silicon Valley Bank.[9] As Silicon Valley Bank's largest depositor, Circle was the primary beneficiary of the federal government's decision to backstop the bank's uninsured deposits in order to stave off broader financial contagion.[10]

Financial regulators have identified a number of other major risks that stablecoins pose to consumers and the banking system, including:

- Payment system risks, "including credit risk, liquidity risk, operational risk, risks arising from improper or ineffective system governance, and settlement risk," that could erode consumer protections;[11]

- Run risk, "a self-reinforcing cycle of redemptions and fire sales of reserve assets" triggered by a loss of confidence in reserve assets backing a stablecoin, which could destabilize funding markets and spark runs on other stablecoins, bank deposits, and financial institutions;[12]

- Risks associated with a rapid growth of stablecoin usage, including an excessive concentration of economic power, systemic risk to the financial system and the real economy, higher borrowing costs, and decreased credit availability.[13]

Stablecoins also pose risks to our national security. According to blockchain analytics firm Chainalysis, stablecoins now account for the majority of all illicit transaction volume, overtaking bitcoin.[14] In particular, stablecoins are driving the two most common forms of crypto crime by transaction volume: crypto scams and crypto transactions associated with

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[7] Bank of International Settlements, "Will the real stablecoin please stand up?," Anneke Kosse, Marc Glowka, Ilaria Mattei and Tara Rice, November 2023, p. 16, https://www.bis.org/publ/bppdf/bispap141.pdf.

[8] *Id.,* p. 17.

[9] S&P Global, "Stablecoin risk, quantified," https://www.spglobal.com/_Assets/documents/Ratings/Product-PDFs/SSA_Brochure_Launch_Edition.pdf.

[10] Bloomberg, "The Big Names That Got Backstop for Billions in Uninsured SVB Deposits," Lizette Chapman and Jason Leopold, June 23, 2023, https://www.bloomberg.com/news/articles/2023-06-23/fdic-insured-billions-in-deposits-for-sequoia-other-top-svb-customers.

[11] *Id.*

[12] President's Working Group on Financial Markets (PWG), Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Report on Stablecoins," November 2021, p. 12, https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf.

[13] *Id.,* p. 14.

[14] Chainalysis, "2024 Crypto Crime Trends: Illicit Activity Down as Scamming and Stolen Funds Fall, But Ransomware and Darknet Markets See Growth," January 18, 2024, https://www.chainalysis.com/blog/2024-crypto-crime-report-introduction/.

sanctioned entities.[15] Chainalysis notes that "[s]anctioned entities, as well as those operating in sanctioned jurisdictions or involved with terrorism financing, also have a greater incentive to use stablecoins, as they may face more challenges accessing the U.S. dollar through traditional means, but still want to benefit from the stability it provides."[16]

Treasury has similarly determined that stablecoins may be uniquely attractive to bad actors. Its 2024 National Terrorist Financing Risks noted that stablecoins "may enable terrorist groups to utilize virtual assets while mitigating the financial risks associated with price fluctuations" and "may be preferred by [virtual asset service providers] used by terrorists to exchange virtual assets for fiat currency. Reporting and private sector analysis indicate that ISIS and other terrorist groups have moved towards using stablecoins, including Tether, to move or store funds."[17] Treasury's 2024 National Proliferation Financing Risk Assessment, moreover, described indictments against North Koreans who used fake personas to get information technology jobs, including at U.S. blockchain development companies, and requested payment in stablecoins like Tether and USDC, which allowed them to funnel their earnings back to North Korea.[18] Treasury cited stablecoins' risks in November 2023 when requesting additional authorities from Congress – including expanding the scope of the Bank Secrecy Act to encompass more crypto activities – to crack down on crypto illicit finance.[19]

Efforts to integrate stablecoins into the banking system must also grapple with the risks posed by stablecoins issued over public, permissionless blockchains. Most stablecoins – including Tether and USDC, which together account for 90% of stablecoin market cap[20] – are issued over public blockchain networks like Ethereum in which no prior approval is needed for parties to participate in the settlement and processing of stablecoin transactions and the communication of transactions to other participants.[21] Financial regulators have recognized the risks of public blockchain networks:

- In its January 2023 "Joint Statement on Crypto-Asset Risks to Banking Organizations," the Federal Reserve (Fed), the Federal Deposit Insurance Corporation , and the Office of the Comptroller of the Currency stated, "the agencies believe that issuing or holding as principal crypto-assets that are issued, stored, or transferred on

[15] *Id.*
[16] *Id.*
[17] Department of the Treasury, "2024 National Terrorist Financing Risk Assessment," February 2024, p. 20, https://home.treasury.gov/system/files/136/2024-National-Terrorist-Financing-Risk-Assessment.pdf.
[18] Department of the Treasury, "2024 National Proliferation Financing Risk Assessment," February 2024, https://home.treasury.gov/system/files/136/2022-National-Proliferation-Financing-Risk-Assessment.pdf.
[19] The Block, "U.S. Treasury's Wally Adeyemo calls for more authority to go after bad actors in crypto," Sarah Wynn, November 29, 2023, https://www.theblock.co/post/265227/u-s-treasurys-wally-adeyemo-calls-for-more-authority-to-go-after-bad-actors-in-crypto.
[20] The Block, "USD Pegged," accessed February 15, 2024, https://www.theblock.co/data/stablecoins/usd-pegged.
[21] President's Working Group on Financial Markets (PWG), Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Report on Stablecoins," November 2021, https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf.

an open, public, and/or decentralized network, or similar system *is highly likely to be inconsistent with safe and sound banking practices*" (emphasis added).[22]

- The Fed's order denying Custodia Bank, a state-chartered crypto bank, membership in the Federal Reserve System noted: "The pseudonymity of crypto-asset transactions may also lead to financial institutions unknowingly but directly engaging in what may result in illicit financial activity. Crypto-asset transactions on some blockchains, including Ethereum, rely on distributed networks of anonymous persons for validation. Validators perform this service in exchange for earning crypto-assets, which may take the form of an award for validations (for bitcoin "miners") or a tip from transactors as payment for the validation ("transaction processing fees"). These transaction processing fees on some blockchains, including Ethereum, go to unknown validators, which may include illicit actors or sanctioned entities. To the extent a financial institution pays such transaction processing fees, it is risking making payments that support illicit finance or terrorist activity or to a prohibited jurisdiction or entity."[23]

- The Fed's order further explained that on Ethereum, "no screening or diligence is done to determine if validators are sanctioned persons…Additionally, validators are pseudonymous and randomly selected, and transactors cannot select particular validators that have been identified or screened for sanctions risks."[24]

Banking regulators' determinations that crypto-assets issued over public blockchains are highly unlikely to be consistent with safety and soundness and inherently risk violating the Bank Secrecy Act and Anti-Money Laundering rules raise serious questions about how to reconcile efforts to fold stablecoins into our traditional banking system, as your committee has proposed.[25]

The crypto industry's spending on stablecoin lobbying was on track to reach record highs last year as "[f]ederal regulation [for stablecoins] would lend legitimacy to the asset class that could lead to broader adoption."[26] As Congress continues to deliberate over the appropriate regulatory framework for stablecoins, policymakers should be weary of efforts to integrate stablecoins into the formal banking system – or extend any of the concomitant safety net

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[22] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, "Joint Statement on Crypto-Asset Risks to Banking Organizations," January 3, 2023, p. 2, https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20230103a1.pdf.
[23] Federal Reserve System, "Order Denying Application for Membership," January 27, 2023, p. 33, https://www.federalreserve.gov/newsevents/pressreleases/files/orders20230324a1.pdf.
[24] *Id.*
[25] President's Working Group on Financial Markets (PWG), Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Report on Stablecoins," November 2021, https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf; Reuters, "US congressional committee advances stablecoin bill," Hannah Lang, July 27, 2023, https://www.reuters.com/technology/us-congressional-committee-fails-reach-deal-stablecoin-bill-chair-says-2023-07-27/.
[26] Bloomberg, "Stablecoin Push Unleashes Flood of Crypto Lobbying Cash in US Congress," Allyson Versprille and Bill Allison, December 20, 2023, https://www.bloomberg.com/news/articles/2023-12-20/stablecoin-bill-push-unleashes-crypto-lobbying-cash-in-us-congress.

protections to stablecoin issuers – without strong rules that ensure safety and soundness, respect the bedrock principle of "same risk, same activity, same regulation," and mitigate risks to consumers, financial stability, and our national security.

Sincerely,

Elizabeth Warren
United States Senator