IV. Stablecoin: What It Takes to Make It Work

A. Introduction

Stablecoins, a type of cryptocurrency backed by assets in reserve,[1] have recently attracted regulators' attention. Examples of stablecoins include the "Libra" project proposed by Facebook in 2019 and the "Gemini Dollar" issued by a New York trust company.[2] Although stablecoins could potentially function as a reliable alternative to cryptocurrencies such as bitcoin, they also pose significant challenges for regulatory agencies and legislators. As stablecoins continue to attract the market's attention with their growing prominence, regulators around the world are struggling to construct a suitable regulatory framework for risk management while promoting payment innovation. In the United States, the current financial regulation framework predates the age of fintechs,[3] and the regulatory structure around fintechs is still under constant development. The fragmented nature of U.S. fintech regulation extends to regulations on stablecoins and may hinder their effectiveness.

This article explains the current regulatory framework that federal regulators established around stablecoins, as well as the ongoing efforts to improve oversight and provide consumer protection. Part B provides the background information on stablecoins' general features, functionality, their potentials, and the challenges they pose to regulators. Part C discusses the treatment of stablecoins under different regulatory authorities and demonstrates that the fragmented and undetermined nature of regulation on stablecoins undermines the effectiveness of oversight and compliance. Part D proposes that legislators, instead of regulators, should constitute the principal forces

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[1] Press Release, Off. of the Comptroller of the Currency, Federally Chartered Banks and Thrifts May Engage in Certain Stablecoin Activities (Sept. 21, 2020), https://www.occ.gov/news-issuances/news-releases/2020/nr-occ-2020-125.html [https://perma.cc/46J8-X8UD].

[2] GEMINI TRUST COMPANY, LLC, THE GEMINI DOLLAR: A REGULATED STABLE VALUE COIN (2018), https://www.gemini.com/static/dollar/gemini-dollar-whitepaper.pdf (describing the Gemini dollar); Rory Copeland, *A Global Stablecoin: Revolutionary Reserve Asset or Reinventing the Wheel?* (Oct. 22, 2019), https://ssrn.com/abstract=3473692 (discussing the introduction of Facebook's "Libra project," a "global stablecoin").

[3] FIN. STABILITY BD., FINTECH AND MARKET STRUCTURE IN FINANCIAL SERVICES 8 (2019), https://www.fsb.org/wp-content/uploads/P140219.pdf.

in setting guidelines to oversee stablecoins. It also discusses a recent Congressional initiative to fit stablecoins into a regulatory framework, although the initiative may ultimately not be fruitful. Part E concludes.

B. Background

1. What Stablecoins Are and How They Work

Stablecoins, as a sub-category of cryptocurrencies, function with the support of blockchain technology, which provides a safe mechanism for parties with no pre-existing relationship to transact without the fear of being defrauded.[4] The issuers of stablecoins usually consist of accredited financial institutions, such as investment banks and credit unions, and the value of stablecoins is backed by other assets, which stabilize—as the name suggests—the price of stablecoins.[5] Depending on their underlying assets, stablecoins are usually divided into three types: (1) fiat or commodity-backed stablecoins, (2) cryptocurrency-backed stablecoins, and (3) algorithmic-backed stablecoins.[6] Fiat or commodity-backed stablecoins are backed by fiat currency such as U.S. dollars or other low volatility assets such as commodities or securities.[7] Cryptocurrency-backed stablecoins are backed by other established crypto assets such as Bitcoins, Ethers, or other cryptocurrencies.[8] Algorithmic-backed stablecoins are dependent

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[4] Copeland, *supra* note 2 (explaining how blockchain technology provides a reliable mechanism for transaction).

[5] *Id.* ("The role of the financial institutions, association or central bank is merely to issue the crypto currency and perform an IT function.").

[6] Marissa Lee, Student Gallery, *Stablecoin: Yet Another Layer of Cryptocurrency Complexity*, ABI J., Sept. 2019, at 36 ("Stablecoin comes in three types: fiat- or commodity-backed, cryptocurrency-backed and algorithmic-backed").

[7] *Id.* at 36 ("[Fiat- or commodity-backed stablecoin] is backed by an asset such as a fiat currency, gold or other commodity."); Lene Powell, *CFTC Advisory Committee Delves into Stablecoins*, JIMHAMILTONBLOG (Mar. 3, 2020), https://jimhamiltonblog.blogspot.com/2020/03/cftc-advisory-committee-delves-into.html ("A class of virtual currencies that seek to offer price stability against another asset, frequently by being 'backed' by that asset in reserve, like fiat currency(ies) or certain physical commodities (e.g., precious metals[.]").

[8] Lee, *supra* note 6, at 36 ("[Cryptocurrency-backed stablecoin] is backed by another cryptocurrency, usually a top-ranked one with large market capitaliza-

on "algorithms that expand and contract the supply of stablecoins in a way that is similar to how central banks stabilize prices."[9] Examples of stablecoins include Paxos,[10] Gemini Dollars,[11] Tether,[12] and the hotly-debated Libra project announced by Facebook in 2019.[13]

Stablecoins have a relatively simple issuing mechanism. While the issuance of other types of cryptocurrencies mostly involves a decentralized "mining" process,[14] stablecoins are usually issued by a centralized association whose function resembles a central bank.[15] When customers purchase stablecoins, they are "minted" by the issuing association; then, when the customer wishes to "redeem" or sell the coins at a price depending on the underlying asset, they are accordingly destroyed.[16] Additionally, software platforms that allow for the development of decentralized applications, such as the Ethereum network,[17] are required to store and transfer stablecoins.[18]

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tion such as bitcoin or ether, or a blended portfolio of multiple cryptocurrencies.").

[9] *Id.*

[10] Powell, *supra* note 7.

[11] GEMINI TRUST COMPANY, LLC, *supra* note 2.

[12] TETHER, TETHER: FIAT CURRENCIES ON THE BITCOIN BLOCKCHAIN (2014), https://tether.to/wp-content/uploads/2016/06/TetherWhitePaper.pdf.

[13] Oliver Read & Stefan Schäfer, *Libra Project: Regulators Act on Global Stablecoins*, 55 INTERECONOMICS 392 (2020), https://www.intereconomics.eu/contents/year/2020/number/6/article/libra-project-regulators-act-on-global-stablecoins.html (discussing stablecoins and Facebook's Libra project).

[14] *See Frequently Asked Questions*, BITCOIN.ORG, https://bitcoin.org/en/faq#what-is-bitcoin [https://perma.cc/ZRP2-3ZXY] (explaining the issuance of bitcoin through "mining").

[15] *See* Read & Schäfer, *supra* note 13, at 392 ("[Stablecoins] rely on a set of stabilization tools which are supposed to minimise fluctuations of their price in such currency.").

[16] *See id.* at 393 ("Coins are minted when [authorised resellers] purchase Libra and destroyed when they sell Libra."); GEMINI TRUST COMPANY, LLC, *supra* note 2, at 2 ("Gemini dollars are redeemed or 'destroyed' at the time of deposit into the Gemini platform.").

[17] Jake Frankenfield, *Ethereum*, INVESTOPEDIA (Feb. 18, 2020), https://www.investopedia.com/terms/e/ethereum.asp (explaining the Ethereum network).

[18] *See* GEMINI TRUST COMPANY, LLC, *supra* note 2, at 2 ("Gemini dollar require a network that allows for the development of decentralized applications … to store and transfer value ….").

2. Why Stablecoins Matter

One of the most essential advantages of blockchain transactions over traditional banking transactions is that they allow the transfer of intangible assets (e.g., bonds, stocks) without having to adjust various debt relationships between the participants, thereby reducing transactional costs.[19] Additionally, well-functioning digital currencies could increase the speediness of transactions, provide global reach to investments, and allow smooth integration with other technological payment innovations such as digital wallets.[20] As the costs of cash present significant burdens to the financial system, alternative payment system innovations like stablecoins have the potential to reduce such costs and provide greater access to financial services.[21] However, prominent cryptocurrencies, such as Bitcoin and Ether, although recently seeing an overall increase in their market value,[22] fluctuate significantly in prices and are susceptible to market manipulation.[23] Although these qualities make Bitcoins and Ethers attractive investments, they also make them unsuitable as means of transaction.[24]

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[19] *See, e.g.*, Frankenfield, *supra* note 17 ("Ethereum is an open-source, blockchain-based, decentralized software platform used for its own cryptocurrency, ether. It enables SmartContracts and Distributed Applications (ĐApps) to be built and run without any downtime, fraud, control, or interference from a third party.").

[20] Tobias Adrian & Tommaso Mancini-Griffoli, *Digital Currencies: The Rise of Stablecoins*, IMF: BLOG, (Sept. 19, 2019), https://blogs.imf.org/2019/09/19/digital-currencies-the-rise-of-stablecoins/#:~:text=Low%20costs%2C%20global%20reach%2C%20and,proprietary%20legacy%20systems%20of%20banks (listing several potential benefits of stablecoins).

[21] Bhaskar Chakravorti & Benjamin D. Mazzotta, *The Cost of Cash in the United States*, INST. FOR BUS. GLOBAL CONTEXT 35 (2013), https://sites.tufts.edu/digitalplanet/files/2020/06/Cost-of-Cash-US.pdf.

[22] Bitcoin, COINDESK, https://www.coindesk.com/price/bitcoin [https://perma.cc/PWB4-YDZ9] (exhibiting Bitcoin's price trend); Ethereum, COINDESK, https://www.coindesk.com/price/ethereum [https://perma.cc/X2QF-SKT2] (exhibiting ethereum's price trend).

[23] Paul Krugman, Opinion, *Bubble, Bubble, Fraud and Trouble*, N.Y. TIMES (Jan. 29, 2018), https://www.nytimes.com/2018/01/29/opinion/bitcoin-bubble-fraud.html (explaining that the price of bitcoin is "almost purely speculative, and hence incredibly volatile").

[24] XAVIER VIVES, OECD, DIGITAL DISRUPTION IN BANKING AND ITS IMPACT ON COMPETITION 11 (2020), http://www.oecd.org/daf/competition/digital-disruption-in-financial-markets.htm ("Digital currencies such as bitcoin have

Stablecoins backed by fiat currency and low-volatility assets could potentially address this shortcoming. Leading stablecoins already have great popularization potential as the market capitalization of 28 different stablecoins reached $20 billion by October 4, 2020.[25] With appropriate government oversight and regulation (discussed below) to steer its operation and development, stablecoins have the potential to realize the advantages of digital currencies.[26]

3. Challenges to Regulators

Federal regulators face significant challenges when attempting to formulate an appropriate framework to fulfill the pre-requisite of implementing a successful digital currency regulation. A well-functioning system, according to a recent G7 report on stablecoins, should be able to instill public confidence in the reliability of stablecoins and "ensure fair and transparent pricing," as well as exercise sufficient oversight to prevent fraud and market manipulation when the current system cannot effectively self-regulate.[27] The governance framework should also institute risk management policies to strengthen cyber-security and operational resilience.[28]

At the same time, the regulation should be conscious of the relevant Anti-Money Laundering/Combat the Finance of Terrorism

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inherent drawbacks … that make them a speculative investment instead of a store of value and/or means to transact").

[25] Jamie Redman, *Stablecoin Supply Doubles in 3 Months as Combined Market Cap Surpasses $20B*, BITCOIN.COM, (Oct. 4, 2020), https://news.bitcoin.com/stablecoin-supply-doubles-in-3-months-as-cumulative-market-cap-surpasses-20b/.

[26] *See* Adrian & Mancini-Griffoli, *supra* note 20 (addressing the advantages of stablecoins).

[27] G7 WORKING GRP. ON STABLECOINS, INVESTIGATING THE IMPACT OF GLOBAL STABLECOINS 9 (2019); *see, e.g.*, Joseph Young, *Tether Spotlight Once Again: Controversy over 100% Peg to USD*, NEWSBTC.COM, https://www.newsbtc.com/news/tether-spotlight-once-again-controversy-over-100-peg-to-usd/ (last visited Feb. 19, 2021) (mentioning the Department of Justice's criminal investigation of potential market manipulation of Tether, a stablecoin, to drive up the prices of Bitcoin and the suspicion that the operating company of Tether maintained an insufficient U.S. dollars reserve to back its value).

[28] G7 WORKING GRP. ON STABLECOINS, *supra* note 27, at 8 ("Operational resilience and cyber security are core aspects concerning the safety of payment systems").

(AML/CFT) risks that arise because crypto-assets, due to their anonymous nature, could easily facilitate terrorist financing and money laundering.[29] Because blockchain technology allows quick exchange between different virtual assets within a short timeframe, this "chain-hopping" technique makes possible the "layering of illicit funds" and creates great difficulties to trace its origins.[30] The extent of AML/CFT mitigation measures, therefore, would determine the effectiveness of the regulation. Additionally, with respect to global scale stablecoins (GSCs), the regulators must be able to impose legal consequences in cross-jurisdictional claims against failed payments or misappropriation of tokens to support continuity of services.[31] This is especially true when transactions are executed by a different entity than the issuing association under some stablecoin models.[32]

Finally, the regulators should strike a proper balance between "protecting the public" and "allowing opportunities for innovation" when formulating policies and regulations for stablecoins.[33] To create a benign competitive environment and foster the growth of financial service, the regulators must be able to preserve the integrity of the payment system and ensure the safety of the stablecoin transactions.[34] This may require increased oversight from governmental agencies and

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[29] *Id.* at 7 ("If not effectively regulated and supervised, cryptoassets, including stablecoins, can pose significant risks to financial integrity and may create new opportunities for money laundering, terrorist financing and other illicit financing activities").

[30] FATF, FATF REPORT TO THE G20 FINANCE MINISTERS AND CENTRAL BANK GOVERNORS ON SO-CALLED STABLECOINS 8 (2020), http://www.fatf-gafi.org/media/fatf/documents/recommendations/Virtual-Assets-FATF-Report-G20-So-Called-Stablecoins.pdf.

[31] G7 WORKING GRP. ON STABLECOINS, *supra* note 27, at 11 ("Providing appropriate levels of consumer/investor protection becomes more challenging, as the cross-border nature of a GSC means it is subject to a variety of regulatory frameworks in differing jurisdictions.").

[32] *Id.* at 11; Copeland, *supra* note 2 ("The Libra model involves an unbundling of the traditional banking payments process whereby the operator of the blockchain (which executes transactions) is not necessarily the same entity as the reserve with which purchasers deposit money in return for tokens.").

[33] Michael Segal, *Cryptocurrency Regulation under US Securities Laws and Proposed Amendments*, 36 COMPUT. & INTERNET L., no. 9, 2019, at 13.

[34] G7 WORKING GRP. ON STABLECOINS, *supra* note 27, at 7 ("Effective regulation and oversight of stablecoin arrangements is critical to achieve the public policy goals of payment system safety and efficiency.").

heightened disclosure obligations. Meanwhile, overregulation may have chilling effects on market innovation if the relevant policies do not take the unique characteristics of stablecoins into consideration.[35]

C. Current Regulation of Stablecoins

The current regulatory framework of stablecoins predates the age of cryptocurrencies, and it does not take into consideration the unique issues brought by stablecoins. Instead, depending on their characteristics and design, stablecoins could be treated as a security, commodity, or derivative, which subjects them to different regulatory regimes and authorities.[36] This creates a lot of confusion and significantly increases the compliance costs for stablecoins exchanges and their bank partners.

1. Securities Law

According to a statement published by the President's Working Group on Financial Markets (PWG), stablecoins could potentially be treated as securities.[37] If a stablecoin qualifies as a security, it must comply with the various responsibilities under the Securities Act of 1933 ('33 Act), including that it should "either be registered under its provisions or to qualify for an exemption from registration."[38] Accordingly, the "offers and sales" of stablecoin must comply with the registration requirement of the '33 Act, the "intermediaries and other market participants" must comply with the Securities Exchange Act of 1934 ('34 Act), and "issuers and other market participants may be subject to the provisions of the Investment Company Act of 1940 and

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[35] Segal, *supra* note 33, at 13 ("To avoid stifling innovation, that regulatory system should not be overly cumbersome and should address the unique nature of cryptocurrencies.").

[36] Press Release, U.S. Dep't of the Treasury, President's Working Grp. on Fin. Mkts. Releases Statement on Key Regulatory & Supervisory Issues Relevant to Certain Stablecoins (Dec. 23, 2020), https://home.treasury.gov/news/press-releases/sm1223 ("Depending on its design and other factors, a stablecoin may constitute a security, commodity, or derivative subject to the U.S. federal securities, commodity, and/or derivatives laws.").

[37] *Id.* at 1.

[38] *Framework for "Investment Contract" Analysis of Digital Assets*, U.S. SEC. & EXCH. COMM'N (Apr. 3, 2019), https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets (last visited Feb. 19, 2021).

the Investment Advisers Act of 1940."[39] The '33 Act requires the offer or sale of securities to be "accompanied the 'full and fair disclosure' afforded by registration with the Commission and delivery of a statutory prospectus" to allow investors to make an informed decision.[40] If stablecoins must comply with the registration requirement, the issuing association may incur significant compliance costs, which may have a prohibiting effect on the market.

To determine whether a particular stablecoin falls under the definition of a security, courts would look to the '33 Act and the test developed in *SEC v. W.J. Howey Co.* (the "*Howey* test") and evaluate "whether a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or third party."[41] If a stablecoin, although not conceived as a security, possess the properties of a security under § 2(a)(1) of the '33 Act and the *Howey* test, then it would still be subjected to the authority of the SEC and the various duties under the '33 Act.[42]

When evaluating whether a cryptocurrency, including stablecoins, is a security, courts would perform an "investment contract analysis" and apply the *Howey* test.[43] Under the § 2(a)(1) of the '33 Act, "security" includes "the commonly known documents traded for speculation or investment[,]"[44] "certificate of interest or participation in any profit-sharing agreement," and, most importantly, "investment contracts."[45] An investment contract means "a contract, transaction or scheme" where (1) "a person invests his money" (2) "in a common enterprise" and (3) "is led to expect profits" (4) "solely from the efforts of the promoter or a third party."[46]

Both the courts and the SEC usually find no difficulty in ruling that a cryptocurrency satisfies the first prong of the *Howey*

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[39] Press Release, U.S. Dep't of the Treasury, *supra* note 36, at 2 n.3.
[40] Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Exchange Act Release No. 81207 (July 25, 2017).
[41] Segal, *supra* note 33, at 13.
[42] *Id.* at 15 ("If [a cryptocurrency has the properties of a security,] then it would be treated as a security and US securities laws would apply under the current regulatory system.").
[43] *Id.* at 15–16.
[44] SEC v. W.J. Howey, 328 U.S. 293, 297 (1946).
[45] 15 U.S.C. § 77b (a)(1).
[46] *W.J. Howey*, 328 U.S. at 298–99.

test.[47] However, due to the unique characteristics of cryptocurrencies, depending on their design, they may or may not be an investment in a common enterprise.[48] Some cryptocurrencies are launched through the process called Initial Coin Offerings (ICO), which allows investors to contribute to the development of a cryptocurrency at its early stages.[49] These cryptocurrencies satisfy the common enterprise prong because "the fortunes of the investor are interwoven with and dependent on the efforts and success of those seeking the investment or of third parties."[50] Similarly, because stablecoins are typically issued through a central association, they are likely to satisfy *Howey's* "common enterprise" prong as the fortunes of digital asset purchasers are linked to each other or to the success of the promoter's efforts.[51]

The inquiry of whether stablecoins fall under the definition of security thus focuses primarily on whether there is a reasonable expectation of profits and whether a purchaser relies on the efforts of others. The Securities and Exchange Commission (SEC) provided a framework for analyzing whether certain digital assets are securities but emphasizes that the analysis of stablecoins is "inherently a facts and circumstances determination."[52] Profits realized, within the meaning of the *Howey* test, could be "capital appreciation resulting from the development of the initial investment or business enterprise or a participation in earnings resulting from the use of purchasers' funds[,]" but exclude "[p]rice appreciation resulting solely from external market

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[47] Segal, *supra* note 33, at 16 ("[M]ost cryptocurrencies with ICOs will likely meet the first prong of the *Howley* test."). It is worth noting that the court typically defines "money" more broadly in this context as long as an investor gave something as consideration in return for a financial interest with the characteristics of securities, this prong is satisfied. *See* United States v. Zaslavskiy, No. 17 CR 647 (RJD), 2018 WL 4346339 (E.D.N.Y. Sept. 11, 2018) (finding that a person has invested his money even when the person put in cryptocurrencies as their contribution to the project).

[48] Segal, *supra* note 33, at 17 (explaining why cryptocurrencies such as Bitcoin may not satisfy the common enterprise prong).

[49] *Id.* at 13 ("[N]ew cryptocurrencies began launching through what became known as Initial Coin Offerings (ICO), which allowed investors to participate in the development of cryptocurrencies at their earliest stages.").

[50] *Id.* at 16.

[51] *Framework for "Investment Contract" Analysis of Digital Assets*, *supra* note 38 ("In evaluating digital assets, we have found that a 'common enterprise' typically exists.").

[52] Public Statement, SEC FinHub Staff, U.S. SEC. & EXCH. COMM'N, SEC FinHub Staff Statement on OCC Interpretation (Sept. 21, 2020).

forces[.]"[53] The SEC listed some factors to consider when determining the last two prongs of the *Howey* test.[54] The more a stablecoin exhibits those characteristics, the more likely it is for it to be deemed a security.[55] For example, if there are "essential tasks or responsibilities performed and expected to be performed by an [Active Participant (AP)], rather than an unaffiliated, dispersed community of network users," and if a stablecoin's "[p]urchasers would reasonably expect the AP to undertake efforts to promote its own interests and enhance the value of the network or digital asset," then it is likely for a court to find that the stablecoin satisfies the last two prongs of the *Howey* test.[56] However, because stablecoins vary in characteristics and because no authorities have definitively ruled on the treatment of any specific stablecoins, it is uncertain whether any prominent stablecoins, such as Tether and the proposed Libra project, would satisfy the *Howey* test.[57]

2. Commodity Exchange Act

Stablecoins could also potentially be treated as commodities or derivatives and subject to the relevant regulations under the Commodity Exchange Act (CEA).[58] Because some stablecoins are backed by commodities or derivatives rather than fiat currencies, they may assume the regulation imposed on its underlying asset.[59] Because

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[53] *Framework for "Investment Contract" Analysis of Digital Assets*, *supra* note 38 (footnote omitted).
[54] *Id.*
[55] *Id.* ("Although no one of the following characteristics is necessarily determinative, the stronger their presence, the more likely it is that a purchaser of a digital asset is relying on the 'efforts of others'[.]").
[56] *Id.*
[57] Press Release, U.S. Dep't of the Treasury, *supra* note 36; *see, e.g.*, Simon Chandler, *Will Tether Be Classified as a Security and Sued by the SEC?*, CRYPTOVANTAGE (Jan. 12, 2021), https://www.cryptovantage.com/news/will-tether-be-classified-as-a-security-and-sued-by-the-sec (explaining why the current regulation "leaves the door open for Tether to be classed as either a commodity or derivative, rather than a security.").
[58] Press Release, U.S. Dep't of the Treasury, *supra* note 36, at 2 ("Depending on its design and other factors, a stablecoin may constitute a security, commodity, or derivative ….").
[59] COMMODITY FUTURES TRADING COMM'N, *Customer Advisory: Understand the Risks of Virtual Currency Trading*, https://www.cftc.gov/LearnAndProtect/AdvisoriesAndArticles/understand_risks_of_virtual_currency.html

certain cryptocurrencies, such as Bitcoin, have been determined to be commodities, it is very likely for stablecoins to fall under the authority of the CEA.[60] Additionally, any virtual currency-based futures contracts must comply with the regulation of the CEA.[61]

If a stablecoin constitutes a commodity or derivative under the CEA, then the offers and transactions of that stablecoin "may be subject to swap transaction-level requirements" of the CEA.[62] Additionally, the intermediaries that facilitate the trading of stablecoins, namely the issuing association and potential promoters, may constitute "futures commission merchants," "commodity pool operators," or "commodity trading advisor"[63] and be "subject to various registration requirements" of the CEA.[64] In addition, "derivatives involving non-eligible contract participants" (non-ECPs) are subject to the rules made by the Commodity Futures Trading Commission (CFTC) of a CFTC-registered designated contract market.[65]

Further, "CFTC maintains general anti-fraud and manipulation enforcement authority" over stablecoins that are classified as a commodity under the CEA.[66] The anti-manipulation and anti-fraud rules of the CFTC prohibit the use of any manipulative and deceptive devices and contrivances "in connection with any swap, or contract of

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[https://perma.cc/VV3Z-PEDP] ("The [CFTC] primarily regulates commodity derivatives contracts that are based on underlying commodities.").

[60] *Id.* ("Bitcoin and other virtual currencies have been determined to be commodities under the [CEA].").

[61] *Id.*

[62] Press Release, U.S. Dep't of the Treasury, *supra* note 36, at 2 n.4.

[63] 7 U.S.C. § 1a (28) (defining futures commission merchants as any "individual, association, partnership, corporation or trust" that engages in "soliciting or accepting orders" of various commodities, derivatives, and swaps); § 1a (11) (defining commodity pool operator); § 1a (12) (defining commodity trading advisor).

[64] Press Release, U.S. Dep't of the Treasury, *supra* note 36, at 2 n.4. Under the CEA, a futures commission merchant must be registered with the CFTC and comply with the various duties of a futures commission merchant. 7 U.S.C. § 6d (a).

[65] Press Release, U.S. Dep't of the Treasury, *supra* note 36, at 2 n.4. Under the CEA, eligible contract participants (ECPs) are often financial institution, corporations, or organizations that satisfy a minimum asset requirement and are allowed to engage in high-profile transactions that are not available to average investors. 7 U.S.C. § 1a (18). Non-ECPs typically can only trade on designated contract markets that are registered with the CFTC. 7 U.S.C. § 7(a).

[66] COMMODITY FUTURES TRADING COMM'N, *supra* note 59.

sale of any commodity in interstate commerce, or contract for future delivery on or subject to the rules of any registered entity[.]"[67]

3. Banking Secrecy Act

A recent remark of the director of the Financial Crimes Enforcement Network (FinCEN) revealed that transactions using stablecoins are classified as money services businesses (MSB) under the Banking Secrecy Act (BSA).[68] The Director noted that whether "the stablecoin is backed by a currency, a commodity, or even an algorithm" is not relevant to the characterization of MSBs so long as the institution engages in "accepting and transmitting activity denominated in stablecoins[.]"[69]

Institutions and business that are MSBs must register the business with the Secretary of the Treasury[70] and must comply with the various reporting duties to the FinCEN.[71] For example, MSBs must file a Currency Transaction Report (CTR) with the FinCEN if a transaction or a series of transactions "involve[d] a transaction in currency of more than $10,000."[72] Aside from federal regulation, they may also have to "seek licenses from the various state money transmitter regulators as a payment instrument issuer."[73]

Additionally, all MSBs are required to develop and implement an Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) compliance program.[74] The program requires a system of

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[67] 17 C.F.R. § 180.1(a) (2011).

[68] Kenneth A. Blanco, Director, Fin. Crime Enf't Network, Prepared Remarks of FinCEN Director Kenneth A. Blanco at Chainalysis Blockchain Symposium (Nov. 15, 2019) (clarifying the classification of stablecoins). MSB includes "[a] person doing business …" as a (1) currency dealer or exchanger, (2) check casher, (3) issuer of traveler's checks, money orders or stored value, (4) provider of prepaid access, (5) seller or redeemer of traveler's checks, money orders or stored value, (5) money transmitter, and/or (6) U.S. Postal Service. 31 CFR 1010.100(ff).

[69] Blanco, *supra* note 68.

[70] 31 U.S.C.A. § 5330 (a)(1).

[71] 31 U.S.C.A. § 5331 (outlining the activities that would trigger reporting responsibilities to FinCEN).

[72] 31 C.F.R. § 1010.311.

[73] Gary DeWaal & Lee A. Schneider, Summary Overview of Stablecions and the Law Regarding Stablecoins (Oct. 3, 2019).

[74] 31 C.F.R. § 1020.210 (mandating an AML/CFT compliance program for MSBs).

internal control, designation and training of compliance personnel, and customer due diligence review for banks that provide services in support of a stablecoin project.[75]

4. Office of the Comptroller of the Currency

While the Office of the Comptroller of the Currency (OCC) does not have direct authority over stablecoins, it could impose regulations on banks' transactions with stablecoins. In an interpretive letter released in October 2020 (the "Interpretive Letter"), the OCC addressed the authority of national banks and federal saving associations to hold stablecoins.[76] However, the OCC only allowed national banks and federal saving associations to hold stablecoins "as a service to bank customers."[77] Furthermore, banks and federal saving associations holding must comply with various compliance requirements.

First, banks that hold stablecoins must verify "at least daily" that they have sufficient balances in their reserve account that are equal to or greater than the outstanding stablecoins issued to ensure the redeemability of stablecoins and protect the banks' customers from default.[78] The OCC emphasized that banks must comply with "all applicable laws and regulations," including, for example, deposit related regulations and the due diligence requirements mandated by the BSA.[79] Additionally, they must also institute appropriate control and conduct "sufficient due diligence commensurate with the risks associated with maintaining a relationship with a stablecoin issuer."[80]

On the other hand, although the OCC's Interpretive Letter provides some compliance guidance to stablecoins issuers, the guidance is limited in scope and at best general in nature. Although the OCC acknowledged the other types of stablecoins in the Interpretive Letter, the letter only addressed concerns related to fiat currency

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[75] 31 C.F.R. § 1020.210(a)(2) (listing requirements of an adequate AML/CFT program).

[76] Off. of the Comptroller of the Currency, Interpretive Letter 1172, OCC Chief Counsel's Interpretation on National Bank and Federal Savings Association Authority to Hold Stablecoin Reserves 1–2 (Sept. 21, 2020) ("This letter addresses the authority of a national bank to hold deposits that serve as reserves for certain 'stablecoins.'").

[77] *Id.* at 1.

[78] *Id.* at 1–2.

[79] *Id.* at 4 (outlining deposit related compliance considerations such as deposit insurance coverage and risk monitoring).

[80] *Id.* at 2.

backed stablecoins.[81] Further, these instructions only pointed to several common areas of compliance that would apply to any other services that banks provide. This makes these instructions unlikely to address the specific issues that stablecoins brought, such as those associated with global scale stablecoins (GSCs), which cannot be treated simply like deposits.[82] Adding more to the uncertainties, Brian Brooks, the new Comptroller of Currency, hinted that the OCC may accept applications for national bank charters from payments companies, including cryptocurrency exchanges.[83] This may allow stablecoin exchanges to obtain national bank charters and operate like traditional banks.

D. Legislative Initiatives and Potential

As discussed in Part C, although many regulatory agencies voiced their position on regulating stablecoins, there have not been any uniform answers or definitive guidelines on the treatment of stablecoins, leaving uncertainties for their compliance efforts. Overlapping regulation may create confusion for market players, as regulatory uncertainties create difficulties in estimating management risks, thereby increasing operational and compliance costs. Additionally, the current framework of stablecoin regulation largely depends on regulators' reinterpretation of their authorities under their respective enabling Acts,[84] while legislators largely remained silent. This placed great pressure on regulators who then scrambled to fit stablecoins under their respective authorities within the last two years, resulting in

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[81] *Id.* at 1–2 ("[T]his letter only addresses the use of stablecoin backed on a 1:1 basis by a single fiat currency ….").

[82] G7 WORKING GRP. ON STABLECOINS, *supra* note 27, at 11 (discussing regulatory problems associated with GSCs).

[83] Victoria Guida, *Top Regulator Pushes Ahead with Plan to Reshape Banking, Sparking Clash with States*, POLITICO (Aug. 31, 2020, 6:52 P.M.), https://www.politico.com/news/2020/08/31/currency-comptroller-reshape-banking-406393 (summarizing the statements of Brian Brooks, the new Comptroller of Currency).

[84] *See, e.g.*, *Framework for "Investment Contract" Analysis of Digital Assets*, *supra* note 38 (SEC's framework on regulating cryptocurrencies); COMMODITY FUTURES TRADING COMM'N, *supra* note 59 (CFTC's statement on stablecoins); Off. of the Comptroller of the Currency, *supra* note 76 (OCC's statement on stablecoins).

wide speculations by experts, leaving potential investors in the dark.[85] Further, because the existing framework of financial instruments regulation predates the era of cryptocurrency, regulators' ability to address the issues brought by the unique characteristics of stablecoins, such as cross-border transactions, is greatly limited.[86]

Due to these limitations, the regulation of stablecoins is not optimal if left completely in the hands of the regulators. To address these shortcomings, legislators should assume a more active role and design a more definitive and suitable framework for regulating stablecoins.

1. Congressional Initiatives

Representatives in Congress recently introduced House Bill 8827, also known as the proposed Stablecoin Classification and Regulation Act of 2020 in October 2020 to amend the Federal Deposit Insurance Act (FDIA) and "provide for the classification and regulation of stablecoins."[87] Although the bill did not receive a vote in the House,[88] it is nevertheless illuminating to look at its conception of the stablecoins regulation.

Perhaps the most important and aggressive proposal of the bill was to integrate stablecoins into the definition of "deposit."[89] In the proposed amendment, stablecoins are defined as any cryptocurrencies that are "pegged to the United States dollar," "another national or state currency," or a "functional monetary equivalent" and are issued either with a nominal redemption value, with the intent of establishing an expectation of nominal redemption value, or in a manner that would create an expectation of nominal redemption value.[90] This proposed definition incorporated stablecoins within the realm of deposits and would allow issuers of stablecoins to obtain deposit insurance and

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[85] *See, e.g.*, Chandler, *supra* note 57 (describing speculation on the possibility of SEC's action against Tether for selling unregistered security).
[86] FIN. STABILITY BD., *supra* note 3, at 9 ("[T]he cross-border application of different regimes may hinder global business operations.").
[87] H.R. 8827, 116th Cong. (2019–2020).
[88] *H.R. 8827 (116th): Stablecoin Classification and Regulation Act of 2020*, GOVTRACKS.US, https://www.govtrack.us/congress/bills/116/hr8827 (last visited Feb. 19, 2021).
[89] H.R. 8827, § 3(a)(1).
[90] H.R. 8827, § 3(a)(2).

further ensure stablecoins' stability.[91] If the proposal is approved, it could greatly strengthen the market's confidence in the reliability of stablecoins.

On the other hand, the proposed amendment to the FDIA also would impose significant restrictions on the issuance and operation of stablecoins. The amendment would prohibit the issuance of stablecoins unless the issuer is "an insured depository institution that is a member of the Federal Reserve System[.]"[92] It would also be unlawful to issue any "stablecoin-related product" or "provide any stablecoin-related service … without obtaining written approval" from the applicable regulatory agencies under the Federal Reserve system.[93] The issuing associations must also comply with the various approval requirements under the proposed section 52, including that they submit "ongoing analysis" reports to prudential authorities outlining the "potential systemic impacts … of the stablecoin."[94]

Additionally, the amendment would impose a rigid constraint to safeguard stablecoins against volatility, requiring issuers of a stablecoin to "take all possible actions" to guarantee the redemption value of the stablecoin and maintain its redeemability.[95] These restrictions could place the stablecoins under the regulatory framework of banks and potentially change the big picture in the stablecoins market. The report on systemic impacts or monetary policy implications required here is particularly interesting, as it recognizes the dynamic nature of the stablecoins market and demands involvement and expertise from practitioners.

The bill represents a recent attempt to capture stablecoins under a relatively uniform regulatory framework. However, the bill did not spark any significant attention in the House, and this, again, may suggest that Congress still lacks the requisite understanding of stablecoins and prefers to remain passive before a fuller picture on the development of stablecoins emerges. Whatever the reason may be, at least in the near future, Congress may be reluctant to take up the role of defining the regulatory framework around stablecoins.

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[91] 12 U.S.C. § 1815(a)(1) (outlining the advantages of becoming an insured depository institution).
[92] H.R. 8827, § 3(b).
[93] *Id.*
[94] *Id.*
[95] *Id.*

E. Conclusion

Stablecoins present a tempting model for an alternative payment system, and regulators must be able to exercise oversight and regulate their operation for their benefits to be fully exploited. Although attempts have been made by many regulators to place stablecoins under their regulatory regime, without a uniform and definitive framework, the effectiveness of these attempts may be severely undermined. The legislators, who may be the best governmental body to provide an answer to this complex question, should take an active role to study and address the issues brought by the uncertainties.

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