Stablecoin Regulation Roundtable
November 30, 2022
hosted by the
Digital Assets Policy Project
Mossavar-Rahmani Center for Business and Government
Harvard Kennedy School

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On November 30, 2022, the Digital Assets Policy Project of the Mossavar-Rahmani Center for Business and Government at the Harvard Kennedy School hosted an all-day roundtable on stablecoin regulation. It was attended by approximately two dozen people, consisting of senior officials of the Biden Administration, leaders of stablecoin issuers and traditional financial institutions that have a significant presence in payments, lawyers with expertise in payments and digital assets, and leading academics. The focus was to discuss what a regulatory framework should look like if we were to create one in order to bring stablecoins within the regulatory perimeter. Comparisons of legislative and other proposals to create such a framework, as well as a comparison of terms of existing stablecoins, were provided to participants as background. These comparisons are attached to this summary.

The event was conducted under Chatham House rules. Consistent with those rules, this summary refrains from referring to any individual, by name or position. Although many participants agreed on a number of issues, there was no formal process for reaching consensus and so this summary also refrains from characterizing any issue as being a point of agreement.

Session One: The first session focused on what should be the key elements of the regulatory framework. What types of institutions should be allowed to issue stablecoins? Should issuers be limited to only insured depository institutions, as proposed by the President's Working Group report of November 2021, or should issuers include or be limited to nonbank institutions, narrow banks or special purpose entities not engaged in other activities? What regulatory requirements are needed to meet prudential, financial stability, and consumer protection goals?

The key points discussed by participants included:

Legal structure/type of entity. Many participants said

Alignment of Regulatory Standards Applicable to Legacy Firms and New Standards Devised for Stablecoin Issuers. A recurring issue raised throughout the day was the need to be attentive to differences between legal standards applicable to legacy financial firms and news standards being considered for application to stablecoin issuers. A case in point was due diligence

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exposure when there is local currency weakness, government instability or similar conditions. Some said that as a general matter, demand for stablecoins might not be driven by consumers, who generally do not perceive the cost of payments. Instead, usage outside of crypto might be driven first by niche areas where merchants see an advantage, such as gaming or the creator community. B2B payments might also be a significant source of increased usage. Some felt stablecoins would become commoditized and that would be desirable: if they are subject to a regulatory framework that requires 1 to 1 backing and other measures to ensure safety and stability, as well as interoperability, then identity of the issuer will not be important. Stablecoins should not be a credit product but rather only a means of payment. They might represent a significant alternative but would not dominate the market. There might be more competition in payments, with banks offering tokenized deposits or other instant payment options. There could be greater concentration in blockchains however, as a smaller number of stablecoin providers consolidated their operations and limited themselves to a smaller number of blockchains.

Session Three: The last session focused on regulation of the distribution and transfer of stablecoins as opposed to the regulation of stablecoin issuers, including, among other things, risks related to transfer on decentralized blockchains (including operational risks, cybersecurity risks and risks related to illicit activity and AML/CTF compliance), privacy, custody arrangements (including self-custody issues), and relationships between stablecoin issuers and platforms for trading or borrowing and lending.

Decentralized Finance and Trading Markets. There was recognition that it may be more difficult to regulate risks related to decentralized blockchains than the issuer-centric risks. Prudential and other requirements developed over the years for traditional financial institutions may be suitable to address issuer-related risks. But the risks related to transfers on decentralized blockchains are new, and may be more challenging because of the lack of a centralized operating entity, although it was noted that there are often groups that exercise some control through governance tokens, administrative keys or otherwise. In the course of this discussion, it was acknowledged that a number of the issues related to decentralized trading platforms and other trading matters might better to addressed in reforms focused on the larger issues of decentralized finance and digital assets regulation, rather than as a by-produce of stablecoin regulation.

KYC and Illicit Finance Issues. A critical question is how to apply KYC/AML/CFT requirements when stablecoins can be transferred to holders that may not be screened by the issuer or any other financial institution. One option is to restrict transfers to hosted wallets, but that may be impractical given the wide usage of self-custody. Another is to rely on the screening that takes place by the issuer as well as any on-ramps or off-ramps—i.e., crypto exchanges, banks and other financial institutions subject to FINCEN requirements-- at the point of redemption or cashing out into fiat currency. The sufficiency of this approach depends on the quality of that screening, but also the options for use of a stablecoin without conversion into fiat currency—that is, what goods or services can be acquired or sold, or other financial transactions consummated, with a stablecoin or other crypto currency. The "holy grail" solution that is yet