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An Overview of H.R. 4766, Clarity for Payment Stablecoins Act

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The House Committee on Financial Services on July 27, 2023, ordered to be reported an amendment in the nature of a substitute of the Clarity for Payment Stablecoins Act (H.R. 4766), sponsored by Chair Patrick McHenry, which would change how stablecoins are regulated. Currently, there is no comprehensive federal regulatory framework specifically designed for stablecoins. Instead, existing state and federal laws and regulations are applied to aspects of the stablecoin industry based on the nature of activities and individual stablecoin features. For example, stablecoin issuers are subject to state money services business licensure regimes and must comply with federal anti-money laundering requirements.

The bill's proposed regulatory framework and licensing process are described below.

Requirements for Issuing Payment Stablecoins

H.R. 4766 focuses on *payment stablecoins*—which it defines as digital assets issued for payment and redeemable at a predetermined fixed amount—that hold assets in reserve that can be used to redeem the stablecoins. The bill would require an issuer to hold at least one dollar of permitted reserves for every dollar worth of stablecoins outstanding/issued. The bill would limit acceptable reserves to coins and currency, insured funds held at banks and credit unions, short-dated Treasury bills and repurchase agreements backed by Treasury bills, or central bank reserve deposits. Issuers would be prohibited from using reserves except to create liquidity for redemptions. Despite limiting reserves to safe assets, capital and liquidity requirements might still be needed to mitigate run risk, and the bill would require relevant regulators to jointly issue capital, liquidity, and risk management rules for both federal and state stablecoin issuers.

Issuers would be required to establish and disclose stablecoin redemption procedures and to publish monthly reports on outstanding stablecoins and reserve composition. The bill would require the report to be "examined"—as opposed to audited—by a registered public accounting firm and would require that issuers' executives certify the reports, subject to criminal penalty for knowingly false certifications.

Applications and Regulatory, Supervisory, and Enforcement Regimes

The bill would establish a framework for regulation, supervision, and enforcement of stablecoin issuers. The bill envisions a federal or state option for stablecoin issuers, and issuers could be banks or nonbanks. Banks and credit unions would be subject to federal regulation, while nonbanks would have the option to be subject to state or federal registration and oversight. However, the Federal Reserve would still have rulemaking authority for state-qualified issuers. The bill would clarify that payment stablecoins are neither securities nor commodities, nor are they subject to the jurisdiction of the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC). The bill would amend various securities laws to that end but does not include amendments to any commodity-related sections of the *U.S. Code*.

Subsidiaries of Insured Depository Institutions, Credit Unions, and Nonbank Federal Issuers

Stablecoin subsidiaries of insured depository institutions (IDI), a term that refers to banks and credit unions, would be required to apply with and receive approval from the same banking regulator as that of the IDI. Nonbanks—defined in the bill as entities that are not IDIs or subsidiaries thereof—that choose the federal option must receive approval from the Fed.

Applications would be evaluated on three key principles: the ability of the applicant to meet the baseline requirements (described above); the "general character and fitness of the management of the applicant;" and consumer risks and benefits. If a decision is not rendered within 120 days, the application would be deemed approved. Regulators would have to justify denied applications and permit an applicant to request an appeal hearing and to reapply.

Subsidiaries of IDIs would be subject to supervision by the primary federal regulator "in the same manner as such [IDI]." Nonbank stablecoin issuers would be required to file reports with, and may be subject to exams by, federal regulators to, among other things, ascertain and evaluate the financial condition and nature of operations of the issuers, the risks to safety and soundness and financial stability, and the systems used for controlling these risks.

The regulators would be permitted to "prohibit a permitted payment stablecoin issuer from issuing stablecoins" or to stop certain activities or issue civil money penalties if the issuer violated the act or any written condition imposed by the regulator in connection with an agreement with the issuer.

State Qualified Payment Stablecoin Issuers

State regulators would presumably approve state qualified payment stablecoin issuers (this is not explicit in the bill) and be responsible for their supervision and enforcement, whereas the Fed would be responsible for writing regulations for these institutions. However, the bill would give state regulators the option of ceding their supervision and enforcement authorities to the Fed. The Fed would also be allowed to take enforcement actions against state issuers in "exigent" circumstances, a term the Fed would be required to define within 180 days of the bill's enactment. It is unclear how the Fed's authority for rulemaking of state qualified payment stablecoins issuers would interact with a clause of the bill that grants state preemption of federal law.

Other Provisions

The bill would establish rules for institutions charged with safeguarding stablecoins and other assets. Specifically, only custodians supervised by either a federal stablecoin regulator—the SEC or the CFTC—or a state banking or credit union supervisor could safeguard stablecoins. It would also prohibit custodians from comingling their own funds with customers, with exceptions. Custodians would be required to "take such steps as are appropriate" to protect customer funds from a custodian's creditors. The bill would also enshrine in law that banks may engage in various activities involving stablecoins.

The bill would establish a two-year moratorium on the issuance of new *endogenously collateralized stablecoins* (colloquially called *algorithmic stablecoins*, stablecoins that rely on the value of another digital asset to maintain a fixed price). In Spring 2022, TerraUSD, a so-called algorithmic stablecoin, lost nearly $16 billion in value. The bill would mandate a study of these instruments but does not subject those in existence prior to the bill's enactment to the bill's regulatory regime.

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