

August 8, 2022

**Department of the Treasury**

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Deputy Director  
Office of Financial Institutions Policy  
1500 Pennsylvania Avenue, NW  
Washington, DC 20220

**Re: Request for Comment on Ensuring Responsible Development of Digital Assets**

Ladies and Gentlemen,

The USDF Consortium<sup>1</sup> applauds the thoughtful approach that the Department of the Treasury (“Treasury”) has taken on digital assets and appreciates the opportunity to comment on this timely request. We write to emphasize that although it is important to consider how to bring non-bank digital asset providers under a stronger regulatory framework, regulators must also work to create a clear credible path for regulated entities like banks to offer digital asset services, in particular tokenized deposits. Currently, such a path does not exist, and failure to create one in the near term will keep many of the benefits of digital asset technology from being fully realized.

Distributed ledger technology holds tremendous promise to improve financial services, offering faster, cheaper services that can help promote financial inclusion, drive economic growth, and support the role of the U.S. Dollar as the global reserve currency. We can only realize these benefits when this innovation is delivered responsibly and regulatory guidelines are clear, certain, and consistently applied. As the regulatory framework evolves, it is critical to extend existing protections while ensuring we maintain the numerous benefits that our banking system provides today.

The bank regulatory framework provides a tested regulatory structure for digital money. As a group of insured depository institutions, USDF’s members believe that banks are well-positioned to deliver customers the benefits of blockchain technology from trusted partners.

To date, most blockchain innovation has occurred outside of this regulatory structure in novel cryptocurrency markets. These markets have provided testing grounds that have proven the opportunities blockchain technology can deliver. However, the volatile nature of these assets and the inconsistent regulation in these markets has limited the real-world impact of this technology and resulted in unacceptable risk. Despite the numerous innovations in decentralized lending (de-fi), you can’t typically use a de-fi loan to fund the purchase of real-world goods or services.

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<sup>1</sup> The USDF Consortium is a membership-based association of insured depository institutions. Our mission is to build a network of banks to further the adoption and interoperability of a bank-minted tokenized deposit (USDF™). We believe that blockchain technology can make payments more efficient and improve traditional banking services, expanding access to safe and affordable financial services.

As banks respond to growing customer demand for blockchain technology and incorporate them into traditional banking, we can promote access to safe affordable financial services while maintaining critical protections. Blockchain can create an open platform that can power further innovation. With blockchain technology we can:

- facilitate faster, cheaper payments ensuring consumers and companies of all sizes have immediate access to their money.
- add transparency and efficiency that lowers the cost of credit and improves access for creditworthy borrowers,
- promote financial inclusion, by lowering the costs to serve new markets and making it easier for banks to meet the needs of underserved communities, and
- support the role of the U.S. Dollar internationally and ensure that our economy remains the most dynamic in the world.

We believe that the best way to leverage blockchain technology is to extend the existing banking model into this tokenized environment. Today, most consumers and companies hold their money as a digital bank deposit. By creating a tokenized representation of an existing bank deposit, we can bring trusted bank money onto chain.

USDF digital markers represent deposits of an individual depositor at U.S. insured depository institutions. USDF is able to address the consumer protection, regulatory, concerns of non-bank issued stablecoins and offers a safer option for transacting on blockchain.

The bank regulatory structure is designed to manage the risks associated with offering digital representations of money. Banks are subject to strong regulation and proactive supervision that ensures deposits are safe and that consumers receive the appropriate protections. This is why no depositor in an FDIC-insured institution has ever lost a penny of FDIC-insured funds since the FDIC's inception in 1933.

If policymakers want to realize the benefits of blockchain technology while maintaining critical protections, they should look to the bank regulatory framework. Bank deposits are backed by robust capital and are subject to a regulatory regime that ensures liquidity and solvency. For banks, the implementation of blockchain technology does not fundamentally change the nature of banking or how regulation controls for the risks associated with it.

To date, however, U.S. regulators have not created a path forward for banks to offer digital asset services. Although banks have clear legal authority, they must first ask for permission from regulators to commence digital asset activities. Moreover, to date, there is not a clear set of regulatory expectations for banks seeking to provide digital asset services.

Failure to create such a clear set of regulatory expectations for banks will push market participants farther from regulation, thus exacerbating the run risk, illicit finance risk, and cyber risks present in the market today. This risks leaving consumers, investors, and businesses exposed. The USDF Consortium stands ready to assist policymakers as they work to ensure blockchain innovation is delivered responsibly.

## Money is Already Digital, and Tokenization is the Next Step in the Evolution of Money.

We often associate money with paper bills, but the reality is the vast majority of money today is already digital. Money is designed to provide a reliable store of value, serve as a common unit of account, and facilitate transactions as a medium of exchange.

Today, we use both public and private money. In developed economies, public money, which includes cash and accounts held directly at the Federal Reserve, makes up about 5% of money. The other 95% is private money – funds held as a liability of a private institution like a bank or credit union.<sup>2</sup>

While much of this money is already digital, the next step in the evolution of money is tokenization, or using digital blockchain ledgers to record balances and execute payments. Cryptocurrencies have provided a compelling test of this but have yet to connect to the real world. Tokenized money can provide numerous benefits.

With safe tokenized money, consumers and institutions will be able to make faster, cheaper payments leveraging modern blockchain-based rails. Tokenized money is also programmable, allowing for complex transactions to be executed quickly and accurately. This will provide for bringing traditional financial services products onto blockchain, which can add transparency that can make traditional illiquid products like loans more liquid. Among other things, blockchain technology can deliver:

- 365/24/7 operating hours (distributed ledger technologies (“*DLTs*”) are “always on,” while account-based banking systems are not);
- Single sources of truth replaces siloed ledgers across firms;
- programmability (Smart contracts deliver new forms of automation); and
- instant settlement reducing counterparty risks.

These improvements will also promote financial inclusion. Cheaper, faster payments mean that those living on the margin will have access to their money immediately. More liquidity will lower the cost of credit and increase availability for creditworthy borrowers. This will also support our international competitiveness and bolster the role of the U.S. dollar as the reserve currency of the world.

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<sup>2</sup> Harvard Business Review, Stablecoins and the Future of Money (Aug. 10, 2021), <https://hbr.org/2021/08/stablecoins-and-the-future-of-money#:~:text=Public%20money%20includes%20central%20banks,in%20developed%20economies%20is%20private>

## **Bank regulation is best equipped to manage the risks associated with tokenized money.**

There is tremendous value to bringing fiat dollars onto blockchain, but as we do so, we should be careful to maintain the numerous benefits and protections that our banking system provides today.

Trust is the most critical aspect of banking. Deposits often represent a family's life savings and are a key component of their hopes and dreams. Banking is one of the most highly regulated industries in the United States because when things go wrong, it can have serious consequences.

As banks innovate, they do so within an established regulatory framework, backed by strong supervision and oversight that ensures robust customer protection and ensures the safety of deposits. No depositor in an FDIC-insured institution has ever lost a penny of FDIC-insured deposits since the FDIC was created in 1933.

Unfortunately, customers often forfeit these critical protections when they turn to non-banks for financial services. Many innovators have a "fail fast" approach that may make sense in other sectors but doesn't suit banking. Through the past several decades, the banking industry has demonstrated its ability to adapt and modernize in ways that respond to the evolving expectations of bank customers while also protecting them.

Moreover, the bank regulatory structure is designed to maintain important broader public policy objectives. Under the Community Reinvestment Act and other laws, banks have long demonstrated their unique ability to support underserved communities. This law is directly tied to bank deposits. A transition to non-bank deposits risks undermining these critical objectives.

Banks also play a critical role in our economy. Banks engage in maturity transformation, taking short term liabilities in the form of deposits and extending long term credit in the form of loans. These loans are a key driver of economic growth and a critical component of social mobility.

Acting Comptroller Michael Hsu recognized this in a recent speech, highlighting that our current two-tier banking system is "not an accident. It is the result of a carefully architected monetary and banking system. The robustness and reliability of this architecture, combined with the strength of the rule of law in America and the dynamism of our economy, has supported the role of the U.S. dollar as the world's reserve currency."<sup>3</sup>

### Non-bank stablecoins present risks to consumers and the broader economy

Stablecoins are unique in that they are a novel asset that serves as an alternative to a bank deposit. When they fail there are serious consequences for the depositors who trusted in the stable value.

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<sup>3</sup> Acting Comptroller of the Currency Michael J. Hsu, Remarks Before the Institute of International Economic Law at Georgetown University Law Center, "Thoughts on the Architecture of Stablecoins" at 4 (April 8, 2022), <https://www.occ.gov/news-issuances/speeches/2022/pub-speech-2022-37.pdf>.

Not all stablecoins are created equal, and there is a wide spectrum of risk in the stablecoin market. Despite this all stablecoins expose “depositors” to some degree of credit risk. Algorithmic stablecoins are at one end of the risk spectrum. These assets are not backed by any hard assets and rely on a series of economic incentives to maintain their value. The high-profile failure of Terra’s UST token has brought these risks to the forefront.

Asset-backed stablecoins like Tether and Circle’s USDC – represented as being backed dollar for dollar – provide additional security, but ultimately expose their holders to the credit risk of the underlying assets that support that asset. Today there is no consistent regulation that ensures the sufficiency of these assets or controls to ensure that consumer protections are being extended to the holders of these assets. Recently it was reported that hedge funds are shorting the largest asset-backed stablecoin, Tether, making a bet that it will not maintain its dollar value.

By serving as a bridge to the crypto ecosystem, these assets also amplify existing money laundering and sanctions risks.

While stablecoins allow real fiat dollars to be brought on-chain, most non-bank stablecoins carry real credit risk – risk that the issuer will not have adequate assets to honor withdrawals when those assets suffer significant value deterioration tied to the capriciousness of volatile markets. To be credible, tokenized money should not carry credit risk.

#### Retail CBDCs have serious drawbacks that limit their utility

Central banks around the world are exploring the possibility of issuing their own form of tokenized money. These would present a widely accessible digital form of public money. The issuance of a retail CBDC<sup>4</sup> would present a safer alternative to existing non-bank stablecoins. As a direct liability of the central bank, CBDC would carry no credit risk.

While a retail CBDC would present a safer option, it would also undermine critical benefits that our banking system provides today. According to the Federal Reserve, a “widely available CBDC could serve as a close substitute for commercial bank deposits or other low-risk assets such as government MMFs and Treasury bills. A shift away from these assets could reduce credit availability or raise credit costs for households, businesses, and governments.”

Even if delivered through banks, a retail CBDC would ultimately be a liability of the Federal Reserve, not a private institution like a bank. The American Bankers Association estimates that a 71% of bank funding is in deposits that would be put at risk by this model.<sup>5</sup> A flight of deposits to the Federal Reserve would undermine the deposit base that supports lending. Banks across the country rely on these deposits to fund the loans that support small businesses in their community and help families achieve homeownership.

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<sup>4</sup> A “retail” CBDC means a liability of the central bank held directly by a member of the public, unlike a commercial bank deposit, which is a liability of the commercial bank owed to its customer.

<sup>5</sup> American Bankers Association Comments on Federal Reserve Discussion Paper Money and Payments: The US Dollar in the Age of Digital Transformation. <https://www.aba.com/advocacy/policy-analysis/aba-comments-on-fed-discussion-paper-money-and-payments>

An alternative path would be for the Federal Reserve to explore a wholesale CBDC.<sup>6</sup> In doing this they could create modern blockchain-based payment rails while maintaining the same two-tier system that exists today. While there are numerous tradeoffs to consider in this approach, a wholesale CBDC would reduce one of the largest risks of issuing a CBDC and ensure the private sector has the ability to innovate.

Tokenized deposits offer all of the benefits of other approaches but maintain the consumer protections associated with bank regulation.

Tokenized deposits are fundamentally different from existing stablecoins. As a digital representation of an existing bank deposit, tokenized deposits can provide for the rapid settlement, low-cost structure and programmability of a stablecoin but with the regulation and protection of a bank deposit.

Tokenized deposits can be distinguished from stablecoins in one critical way. Stablecoins are digital assets that are newly created by the stablecoin issuer and are designed to have a stable value typically by being pegged to a currency or commodity. Tokenized deposits, on the other hand, are the digital representation of existing liabilities — demand deposit claims — that a bank has on its balance sheet. Importantly, tokenized deposits are obligations of banks, which are highly regulated and closely supervised by bank regulators. This approach maintains the protections of the bank regulatory structure designed to address the risks associated with taking deposits and facilitating payments.

Tokenized deposits maintain fractional reserve banking.

Banks play a critical role in our economy, engaging in maturity transformation. Banks take short-term in the form of deposits and using those funds to extend long-term assets in the form of loans.

When a bank makes a loan, it creates new money in the form of a deposit in the borrower's account that did not previously exist. That deposit in turn can be used to power additional lending. The amount of deposits that can be used to support additional lending is determined by the capital the bank must hold to support new loans. Today the core capital (leverage) ratio for FDIC insured institutions is near 8.7%.<sup>7</sup> This system, called fractional reserve banking, means that a \$1 deposit can power more than \$10 of lending. These loans allow businesses to invest in new employees or capital goods that create jobs and drive economic growth.

Non-bank instruments like stablecoins or CBDC would eliminate this important function. There are many forms of stablecoins, but the recent high-profile failure of Terra's UST has led to a push for fully collateralized stablecoins that hold one dollar in assets for every dollar of the stablecoin. This means that a \$1 stablecoin can only ever support \$1 in lending.

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<sup>6</sup> A "wholesale" CBDC means a CBDC designed for use among financial intermediaries only.

<sup>7</sup> FDIC Quarterly Banking Profile

<https://www.fdic.gov/analysis/quarterly-banking-profile/graph-book/2022mar/QREGCAP.html>

There simply isn't enough capital in the system to support fully collateralizing every financial asset. Today, there are nearly \$200 trillion in U.S. financial assets supported by \$18 trillion of commercial bank deposits.

In a recent post, New York Federal Reserve staff reinforced the importance of this in a recent post titled *The Future of Payments Is Not Stablecoins* where the staff argued in favor of tokenized bank deposits.<sup>8</sup> The post notes that “The emergence of DLTs has led to a proliferation of new types of money, such as stablecoins... In this post, we argue that if DLT platforms are the transfer mechanism of the future, then it seems worthwhile to find the best possible money that can be used on that transfer mechanism. We suggest that tokenized deposits might be a fruitful avenue to pursue.”

Similarly, Federal Reserve research finds that stablecoin deposits at commercial banks, such as USDF's members, are the only model that supports fractional reserve banking. In the paper, they note that “for bank intermediation to remain the same, the treatment of stablecoin deposits has to be the same as non-stablecoin deposits in terms of the required reserve ratio, liquidity coverage and other regulatory and self-imposed risk limits.”<sup>9</sup>

The only scalable way to bring traditional financial assets on-chain is to leverage the banking system to support that by tokenizing existing bank deposits.

## **Policymakers must create a clear credible path for regulated institutions like banks to offer responsible products.**

If policymakers want to realize the benefits of blockchain technology while maintaining critical protections, they are right to look to the bank regulatory framework. The risks presented by stablecoins are exactly what banking regulation was designed to address.

It is no surprise that as policymakers have evaluated stablecoins they have pointed to the importance of the banking regulatory structure to ensure consumers are protected. We agree with the assessments made by the President's Working Group in their Report on Stablecoins<sup>10</sup> which endorsed the idea that banks are best equipped to control for the risks of stablecoins. Banks are the most highly regulated institutions in the country and are subject to a panoply of prudential regulations designed to ensure that they operate in a safe and sound manner.

Much of the focus to date has been placed on how to bring non-bank providers under a stronger regulatory framework. This work is an important step to ensuring consistent application of the appropriate rules. This likely requires legislation and there are thoughtful initiatives in Congress

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<sup>8</sup> The Future of Payments Is Not Stablecoins (February 7, 2022)

<https://hbr.org/2021/08/stablecoins-and-the-future-of-money>

<sup>9</sup> Stablecoins: Growth Potential and Impact on Banking (January 2022)

<https://www.federalreserve.gov/econres/ifdp/files/ifdp1334.pdf>

<sup>10</sup> President's Working Group on Financial Markets Releases Report and Recommendations on Stablecoins (November 1, 2021)

<https://home.treasury.gov/news/press-releases/jy0454>

to address the need. We appreciate Treasury’s commitment to working with Congress to accomplish this.

Today there is not clear path for banks to answer Treasury’s call.

To accomplish its goals, Treasury must also focus on providing regulatory clarity for highly regulated institutions like banks to offer responsible blockchain-based services. If banking regulation is the answer, there should be a clear path for banks to step in and help be part of the solution. Unlike the non-bank workstream, this does not require legislation and can be accomplished under existing regulatory frameworks, as banks already have the legal authority to engage in the relevant digital asset activities.

The bank regulatory structure is well-equipped to supervise blockchain activities at banks. In a recent podcast, former Vice Chair for Supervision Randal Quarles notes that “if you are a bank, then there's nothing much more that needs to be done with respect to your ability to issue with the stablecoins. We will view those liabilities like the other liabilities on your balance sheet and determine in our prudential supervision of your institution in determining your compliance with regulations.”<sup>11</sup>

While banks have clear legal authority to engage in digital asset activities, they must first ask permission from their regulators. To date, no clear set of expectations have been set for regulatory approval.

Beginning in 2020, the Office of the Comptroller of the Currency (“OCC”) issued a series of interpretive letters 1170, 1172, and 1174 which provided clarity national banks can engage in an array of activities related to digital assets. These include custody, holding stablecoin reserves, using stablecoins for payment activities. Many banks believed that these authorities already existed under established banking law, but the interpretive letters were a clear signal that they would not face regulatory challenges by exercising such authority, as regulators were comfortable with banks acting as the responsible providers of these services.

The OCC’s interpretive letter 1179 reaffirmed these important authorities, but took a step backwards imposing extraordinary requirements for banks to obtain written prior non-objection for these activities, a step not required for other permissible activities. Similarly, the FDIC’s Financial Institution Letter FIL-16-2022 requires banks to notify the FDIC prior to engaging in any crypto activities.

These letters sent a clear signal that regulators represented a significant change of tone and served to dissuade banks from seeking approval to engage in these activities. Since the issuance of these letters, no clarity has been offered around regulatory expectations for banks engaged in these activities.

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<sup>11</sup> Banking With Interest: Quarles on Inflation, Politics at the Fed and CBDCs.  
<https://bankingwithinterest.libsyn.com/quarles-on-inflation-politics-at-the-fed-and-cbdcs>



## Regulators should work with banks to create clarity.

The implementation of blockchain technology does not fundamentally change the nature of banking or how regulation controls for the risks associated with it. Blockchain is simply a faster, more efficient ledger than many core systems that banks rely on today. The members of the USDF Consortium are committed to working with regulators to explore the benefits and control for the risks of this technology. As regulators consider the key questions around how to enable blockchain regulation, they should consider the following principles.

1. **Security**: Customers deserve the security that they have come to expect from their banks the systems protecting that data are stored on premises, in the cloud, or on blockchain. They should also expect that their money is backed by safe and sound practices and is never at risk.
2. **Consumer Protection**: Consumers should receive the same protections wherever they turn for their financial services. This requires strong regulation and proactive supervision to ensure the rules are being applied consistently.
3. **Interoperability**: Blockchain-based payments rails should strive for interoperability. Today we see the development of many closed-loop systems that struggle to talk to each other. Without interoperability, these systems will never deliver the promise of more efficient payments. One of the reasons the USDF Consortium was founded was to provide a forum for banks to come together and discuss common standards for blockchain-based payments.
4. **Open Infrastructure**: One of the greatest opportunities that blockchain provides is its ability to facilitate a public platform. This open platform creates a strong base for future innovation and can ensure that banking services are competitive, fair, and inclusive. While this open infrastructure introduces novel risks, we believe there are effective ways to manage any of these risks. Moreover, the open infrastructure has benefits, in terms of resiliency, security, and lower cost of transacting, that, when combined with a strong risk management system, provide the ideal operating environment for financial services. We look forward to working with regulators to better understand blockchain risk management and the benefits of blockchain to ensure a path exists for open and transparent banking infrastructure.

## **Conclusion**

Blockchain technology holds tremendous potential to improve financial services. When delivered responsibly, it has the potential to promote financial inclusion and ensure that the United States remains a global leader. We believe the bank regulatory structure is well-equipped to manage the risks associated with this novel technology and that tokenized deposits are the best way to realize these benefits.

The USDF Consortium was created as a venue for banks to collaborate as they design blockchain infrastructure that will power the future of financial services. We are committed to delivering these innovations responsibly ensuring that our customers receive world-class safety and protections. We are committed to working with regulators to help design a regulatory framework that enables this critical innovation.

Sincerely,  
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