# The Biden Administration Stablecoin Report Misses The Mark

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The President's Working Group on Financial Markets released a new report on stablecoins this week. On the surface, the Biden administration punted. Dig deeper, and the details make the policy whiff look much worse.

For starters, the report fails to provide the regulatory clarity that the crypto industry has been seeking for years. Rather than provide concrete proposals and guidelines for federal agencies to implement immediately, the report urges Congress to pass a new law.

The report even disappointed groups that typically support more regulation. Todd Phillips, the director of financial regulation at the Center for American Progress, told American Banker "I think this is a very problematic report, in that the recommendations really just look at what Congress can do, and not the current authorities of the regulators."

But this critique is minor compared to the details the report *does* provide.

Specifically, the administration wants new legislation to "limit stablecoin issuance, and related activities of redemption and maintenance of reserve assets, to entities that are insured depository institutions." In case that's not clear enough, the report reiterates that the bill should "prohibit other entities from issuing payment stablecoins."

The administration apparently believes that stablecoins can harm their users and pose systemic risks, but that everyone should just wait for Congress to act. Even better, the administration wants Congress to force these supposedly risky stablecoins to be issued *only* by federally insured banks.

That's mindboggling enough, but it takes supreme audacity to make this recommendation while also calling for new regulations to prevent stablecoins from leading to "an excessive concentration of economic power." All crypto innovation—just like most other advances in U.S. payments technology—has been taking place *outside* of the banking sector.

Preventing everyone outside the banking sector from issuing stablecoins removes a major threat of competition from the banking industry. It's a move that makes no sense if the goal is to prevent excessive concentration.

The truly laughable part is that the logic implies the concentration of economic power is bad, but not when the federal government orchestrates it and forces taxpayers to clean up any of the potential mess. (To give the administration credit, this twisted logic does appear consistent with the views of its nominee for the comptroller.)

Given everything in the report, it is very difficult to escape the conclusion that the administration wants to isolate the banking industry from competition and prevent stablecoins from growing in any way other than on the federal government's terms.

This approach is completely misguided. It goes much farther than needed and will likely shut off beneficial innovations in the U.S. payments system.

But there is a much simpler, better way.

As my colleague Jennifer Schulp and I outline in this Cato Institute briefing paper, a sensible alternative would be to regulate the most common types of stablecoins (those backed by cash and short-term securities) with a straightforward set of rules based on preventing fraud and promoting transparency.

The greatest risk for most stablecoin holders is whether the issuing entity has the reserves that it claims to have. A lack of transparency about the reserves prevents holders from evaluating the issuer's claims about stability and does little to protect them from fraudulent misconduct.

A good regulatory framework addresses *this* issue.

It does not have to be complicated. All it has to do is provide basic collateral requirements and require a baseline for transparency. Unlike the administration's proposal, this approach is entirely compatible with a free-enterprise system based on the principles of limited government.

Our paper includes a few more details and sample legislative language, but the basic idea is to require stablecoin issuers to be regulated as a newly created "limited purpose investment company." The issuer would then be subject to basic reserve requirements and mandatory disclosure of relevant information about those reserves.

The administration's approach is dangerously reminiscent of what federal regulators did to money market mutual funds after the 2008 financial crisis. Ultimately, those new rules—in my view, fueled by the Fed's long-running (misguided) hatred of money market funds—helped shrink a once vibrant commercial paper market. It forced more risk out of the well-diversified (short-term) capital markets and into the banking sector.

To be clear, I am not arguing that stablecoins are identical to money market mutual funds. They do share some traits, but they are not the same.

I am, however, claiming that federal regulators are very good at messing up financial markets, and that money market mutual funds have never really recovered from the SEC's 2010 and 2014 rules. They are, for instance, no longer a major source of funding for commercial paper.

Those rules were based on an erroneous account of what happened during the 2008 financial crisis, and a flawed view of financial markets. Regulators relied on an unsound interpretation of the risks that money market funds pose to individual investors, as well as to the broader market (so-called systemic risks).

The Reserve Primary Fund, the one that regulators held up as an example of all that was wrong with money market mutual funds, ultimately returned $0.99 cents per share to its investors.

Yet federal officials took a very simple and effective regulatory framework—one that was not incredibly different than what our paper proposes for stablecoins—and essentially turned it upside down. They needlessly complicated everything and made the risks that they were supposedly diminishing demonstrably worse.

Now that these rules have pushed more short-term funding into government securities and the banking sector, federal regulators are engaged in the spectacle of bringing enforcement actions against asset managers for using bank-based sweep accounts, thus providing clients with yields that are *too low*.

It's not a surprise to find ourselves in this situation.

For decades, policymakers have appealed to the seemingly special nature of financial firms to heavily regulate them, often in the name of preventing turmoil from spreading to the rest of the economy. Increasingly, financial regulations focus on risk management conducted by regulatory agencies rather than on disclosure and fraud prevention.

This approach has failed miserably.

The administration is doubling down, but saddling Americans with even more intrusive, complex regulation that favors large incumbent firms is not the solution. Federal officials have no special knowledge regarding the best way to serve financial firms' customers or investors.

It is long past the time that Congress admits this fact.

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