AMB Inside Look: Cryptocurrency Exchange and Stablecoin CEOs Testify before House Financial Services Committee

Six cryptocurrency CEOs testified before the House Committee on Financial Services on Wednesday, December 8th to discuss the challenges and benefits associated with the emerging cryptocurrency sector. The hearing's tone was exploratory rather than confrontational, as members of the committee sought to better understand terminology and technology that underpins cryptocurrency and blockchain. The CEOs, hailing from some of the most established cryptocurrency firms included, Jeremy Allaire (Chairman and CEO of Circle – a stablecoin issuer), Samuel Bankman-Fried (Founder and CEO of FTX – a cryptocurrency exchange), Brian Brooks (CEO of Bitfury group – a Bitcoin mining and blockchain solutions firm - and former Acting Comptroller of the OCC), Charles Cascarilla (CEO of Paxos Trust – a stablecoin issuer), Denelle Dixon (CEO and Executive Director of Stellar Foundation – a blockchain solutions company), and Alesia Jeanne Haas (CEO of Coinbase Inc. – one of the largest cryptocurrency exchange platforms).

A closer look at risks

Much of the written testimony, and indeed many of the questions from Members of Congress, focused on the various risk mitigation strategies employed by each firm. Mr. Allaire and Mr. Cascarilla confirmed that their stablecoins were backed by cash, cash equivalents, or short-duration U.S. treasuries. This alleviated some of the concerns outlined in the President's Working Group (PWG) report that stablecoin issuers may be backing their coins with risky assets or with no assets at all.

One particularly tense exchange occurred between Chairwoman Waters and Mr. Cascarilla centering on Paxos' partnership with Facebook (Meta) subsidiary Novi. Ms. Waters referenced the PWG report recommending that cryptocurrency firms should limit their affiliation with commercial entities. Mr. Cascarilla noted that the partnership was fairly limited, the recommendations in the PWG are not law and were recently released, and that Novi itself was a regulated money services business. However, expect this issue to be front and center as regulation and legislation is being developed.

Several Representatives inquired about the guardrails exchanges have setup to combat fraud, money-laundering, and sanctions evasion. Ms. Haas, Mr. Brooks, Ms. Dixon, and Mr. Bankman-Fried all noted they conduct substantial "know your customer" screenings, and actively work with law enforcement when necessary. CEOs of exchanges noted that they had stepped up their due diligence of firms listed on their exchanges to avoid exposing their customers to potential scams.

The SEC and Gensler, the common denominator

Members of Congress and the witnesses shared a common concen the lack of clarity from the SEC and its Chair Gary Gensler. While the SEC has previously stated that most cryptocurrency tokens should be registered as securities and thus fall under the agency's purview, they have repeatedly failed to outline a process for this. They have also failed to provide guidance, or specificity on regulatory obstacles. Mr. Brooks, former Acting OCC Comptroller and CEO of Bitfury, stated that the ambiguity and lack of attention the SEC is paying to the industry is stifling innovation and could open the door for heightened risk. Every witness relayed a similar view that the SEC was abdicating its responsibility, and while some had found regulatory clarity with the CFTC, this was insufficient.

Cryptocurrency, Blockchain, and its potential benefits

Additionally, all witness testimony included references to equity and inclusion in finance and how blockchains and cryptocurrency can be leveraged to bring more unbanked, or underbanked individuals to the table. Several Democrats on the committee asked whether cryptocurrency could be used by immigrants who send remittances to family abroad, to speed up and lower costs. While the witnesses replied this was certainly the case, in practice, there has not been a wholesale adoption of cryptocurrency or stablecoins to send remittances. Several witnesses noted that the use of stablecoins and adoption of blockchain technology could help re-cement the dollar's role as the undisputed world reserve currency.

The crypto CEOs repeatedly noted that cryptocurrency was extremely accessible to traditionally underserved, and unbanked individuals as all that is needed is a smart phone. Also, the use of algorithms by crypto firms limits human bias or prejudice, and several CEOs pointed to historical discrimination by banks against minorities. While this may be the case for larger commercial banks, most mutual institutions have stellar track records on community engagement, and the adoption of blockchain or cryptocurrency by mutuals could be a significant opportunity to expand membership and revenue.

Mr. Brooks took an interesting approach to discussing crypto's potential for increasing equity and inclusion. He highlighted the difference between blockchain technology that he believes will underpin the next iteration of the web, and the current system where a few companies (Facebook, Google, Apple, and others) control most of the infrastructure of the internet. Through cryptocurrency and blockchain technology, individuals are able to own and operate pieces of the decentralized Web 3.0 infrastructure thereby increasing equity. Through ownership of tokens or nodes on a given blockchain, users can vote on changes or any other issues. Mr. Brooks also noted several times that blockchain technology creates a public and transparent ledger which further increases equity and inclusion, while also mitigating money-laundering and fraud risks. However, there are still significant barriers including Mr. Brooks' own admission that large players can cause extreme price volatility, and that blockchain analysis is highly technical.

Toward new regulation?

There was broad consensus among the witnesses that more regulation, and calibrated regulation was necessary to help foster innovation and ensure the cryptocurrency industry is safe for investors and individuals. A couple of key regulatory issues including deposit insurance for stablecoins (although they are theoretically collateralized by the assets backing the coin); and the ability for a stablecoin issuer to obtain a bank charter, were discussed. Although it is unclear what position Congress will take on these issues, they dovetail with the recommendations in the PWG report.

Generally, Republican committee members took a softer tone in terms of regulation, warning that too much un-calibrated regulation could stifle innovation and cause the U.S. to fall behind adversaries and allies alike. On the other hand, Democrats appeared more skeptical and were focused on DEI, climate change, and the potential for fraud and abuse. All in all, many members appeared to have unformed positions on cryptocurrency and the hearing served as an introduction to the sector. Although it would be optimal for Congress to enact legislation clarifying cryptocurrency and blockchain regulation, it is unlikely this will come into effect anytime soon. Suffice to say crypto currency offers great promise and competitive threat to community banks. It is imperative that community banks lobby Congress strongly to grade a level playing field. Otherwise, there is the risk of vast deposit outflow to large money center banks which would become the depositories for the stable coin collateral.

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