AMERICA'S MUTUAL BANKS
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MUTUAL ALERT

Stablecoins and Deposit Flight Risk for Mutual Banks

With the passage of the Genuis Act, the numerous impediments that the Biden Administration had placed on the development of crypto currency have been reversed. The regulatory agencies have already begun to issue guidance on a variety of regulatory issues involving banking services for the crypto business. As the regulatory activity to implement the Trump Administration policies on cryptocurrency by year end increases, several trade groups are ramping up their efforts to obtain protections for community banks, many whom fear enhanced flight risk as crypto currency becomes more acceptable to the general public. While the Genuis Act prohibits the payment of interest on stable coins, already commentators are pointing out a number of loopholes which may allow a similar result. At the same time, fintech companies are developing their own products for community banks which may be a hedge against flight risk. The purpose of this alert is to summarize the concerns that many mutual banks have expressed, in order to prepare you for the coming debates.

When customers of mutual banks purchase stablecoins, they typically do so by withdrawing funds from their checking or savings accounts. Those dollars don't disappear — they are transferred to the reserve accounts or custodial banks where the stablecoin issuer holds its backing assets. The bulk of these reserves are likely to be deposited with the largest "too big to fail" (TBTF) banks or in short-term government securities.

Mutual banks depend disproportionately on core retail and small business deposits as their funding base. Even a modest diversion of these deposits into stablecoins can shrink their ability to make loans locally. Unlike larger institutions, small mutual banks cannot easily replace these lost deposits with wholesale or capital markets funding.

Stablecoin issuers seek safe, liquid, large-scale custodians — which usually means major Wall Street or global banks. Thus, money withdrawn from a mutual may end up on deposit at institutions like JPMorgan Chase or Bank of New York Mellon. This dynamic concentrates financial power further in the largest banks, exactly the opposite of what mutual bank community policy advocates have long sought.

Mutual banks lose deposits while still carrying the burden of capital, liquidity, CRA, and safety-and-soundness regulation. The largest banks may end up benefiting by holding the backing assets, while bearing far less relative compliance burden for serving as custodians of stablecoin reserves.

In a crisis of confidence in a stablecoin, reserve flows could rapidly shift — but those funds would almost certainly slosh between the largest custodial institutions, not return to mutual banks. That creates one-way pressure: outflow from small banks, inflow to TBTF institutions, with a narrow path for return.

Systemic Risk

Stablecoins could accelerate deposit consolidation in the largest banks, undermining financial diversity. Mutual banks would face a shrinking funding base while competing with fintechs that can offer payment solutions outside of the regulatory perimeter. This outcome undermines the long-standing U.S. policy goal of supporting a decentralized, community-based banking system.

Unless regulators develop a framework that allows mutual banks to participate in, or benefit from, stablecoin activity, the result will be further concentration of deposits in "too big to fail" institutions at the expense of local lending and financial diversity.

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