



December 1, 2021

VIA E-MAIL

CPMI Secretariat (cpmi@bis.org)
Committee on Payments and Market Infrastructures
Bank for International Settlements

IOSCO Secretariat (consultation-03-2021@iosco.org)
Board of the International Organization of Securities Commissions
Bank for International Settlements

Re: Consultative Report – Application of the Principles for Financial Market Infrastructures to Stablecoin Arrangements

To Whom It May Concern:

The Clearing House Association, L.L.C. (“The Clearing House” or “TCH”)¹ appreciates this opportunity to comment on the Committee on Payments and Market Infrastructure and Board of the International Organization of Securities Commissions (“CPMI-IOSCO”) Consultative Report on the *Application of the Principles for Financial Market Infrastructures* (the “Consultative Report”) to stablecoin arrangements.² The Clearing House commends CPMI-IOSCO for its work on this issue and fully supports uniform application of the Principles for Financial Market Infrastructures (“Principles”) to stablecoin arrangements. The rapid growth of stablecoin arrangements, their use as a payments vehicle, the transfer function associated with them, and the lack in many jurisdictions of a meaningful regulatory and supervisory frameworks applicable to them present unique risks to the financial system that warrant full application of the Principles to such arrangements. While certain design choices that may be made in establishing stablecoin arrangements may present challenges to conformance with the Principles, it is important for the protection of the financial system that the full breadth of the Principles apply. TCH strongly agrees with CPMI-IOSCO that all of the principles, even those not expressly discussed in the paper, should apply.

To further enhance application of the Principles to stablecoin arrangements, TCH makes the following recommendations:

- The guidance should make clear that stablecoin arrangements that are not designed in compliance with the Principles will bear the risk of being prohibited if they are, or are likely to become, systemically important.

¹ The Clearing House Association, L.L.C., the country’s oldest banking trade association, is a nonpartisan organization that provides informed advocacy and thought leadership on critical payments-related issues. Its sister company, The Clearing House Payments Company L.L.C., owns and operates core payments system infrastructure in the U.S., clearing and settling more than \$2 trillion each day. See The Clearing House’s web page at www.theclearinghouse.org.

² Committee on Payments and Market Infrastructure & Board of the International Organization of Securities Commissions, “Application of the Principles for Financial Market Infrastructures to stablecoin arrangements,” Consultative Report (Oct. 2021) (available at: <https://www.bis.org/cpmi/publ/d198.pdf>).

- The guidance relating to the determination of whether a particular stablecoin arrangement is systemically important (section 2.1.3) should be revised so that authorities, in their evaluation of the nature and risk profile of a stablecoin arrangement, take into account whether or not there is an existing regulatory framework in place to appropriately address the risks posed.
- The guidance should be revised to eliminate the “discretion” to consider potential growth and future state of stablecoin arrangements and affirmatively require such consideration. The early identification and designation of stablecoin arrangements that may become systemically important is vital given the ability of such arrangements to scale rapidly due to network effects or relationships between stablecoins and existing user bases or platforms.
- The guidance should be revised to include a requirement that when settlement is conducted with a stablecoin instead of central bank money, the issuer of that stablecoin needs to 1) be a bank or other appropriately regulated financial institution, or 2) deposit the funds at a bank or other financial institution that is appropriately regulated, supervised and has sufficient controls in place to manage the risks arising from the stablecoin arrangement.

I. Stablecoin Arrangements Have Grown Rapidly and Present Numerous Risks

Stablecoin issuers and arrangements have proliferated in the eight years since the first stablecoin was issued.³ As of September 2021, the market capitalization of stablecoins was estimated to be between \$120 and \$125 billion, a 600% increase from 2020,⁴ and stablecoins continue to grow exponentially. Although statistics on stablecoin arrangements by use case/function (e.g., value storage, payment system, exchange/transfer system, etc.) are not available, the rapid growth of specific stablecoin arrangements is readily apparent. Tether’s market value, for example, was estimated to be \$38.1 billion, as of March of this year, with Tether’s 24-hour volume (\$94 billion) almost doubling that of Bitcoin.⁵ As of the end of October, Tether’s market cap was estimated to be approximately \$69.8 billion.⁶ Another widely-held stablecoin, Binance Coin (BNB), was estimated to have a market cap of \$75.8 billion as of the end of October.⁷ Still another, USD Coin, the stablecoin offered by Circle, saw \$32.5 billion in circulation as of October, with \$1.2 trillion having been transferred in total on-chain

³ Tether, the first “blockchain-enabled platform to facilitate the digital use of traditional currencies [as] a familiar, stable accounting unit,” was launched in 2014. See Tether, “What is Tether?” (available at: <https://tether.to/faqs/>).

⁴ See Timothy G. Massad, “Regulating stablecoins isn’t just about avoiding systemic risk,” Brookings (Oct. 5, 2021) (available at: <https://www.brookings.edu/research/regulating-stablecoins-isnt-just-about-avoiding-systemic-risk/>) (estimating that as of August 2021 market capitalization of stablecoins was approximately \$120 billion); and Andrew Ross Sorkin, et al., “Here Come the Crypto Rules,” The New York Times (Sept. 24, 2021) (available at: <https://www.nytimes.com/2021/09/24/business/dealbook/stablecoin-crypto-regulation.html>) (estimating that as of mid-September dollar-tied stablecoins in circulation had a value of \$125 billion).

⁵ Joanna Ossinger, “Rise of Crypto Market’s Quiet Giants Has Big Market Implications,” Bloomberg (Mar. 19, 2021) (available at: <https://www.bloomberg.com/news/articles/2021-03-19/rise-of-crypto-market-s-quiet-giants-has-big-market-implications>) (citing research by CryptoCompare).

⁶ CoinMarketCap, Tether (available at: <https://coinmarketcap.com/currencies/tether/>).

⁷ *Id.* at Binance Coin (available at: <https://coinmarketcap.com/currencies/binance-coin/>).

transactions to date.⁸ Additionally, stablecoin arrangements under development by firms with global footprints, such as Facebook's Diem, have the potential for immense growth and significant, if not systemic, importance immediately upon release into the marketplace.⁹

The emergence of stablecoin issuers and growth of stablecoin arrangements pose a bevy of significant risks. These risks are not merely theoretical.¹⁰ For example, stablecoin issuers have abruptly decided to shut down operations;¹¹ stablecoin arrangements have suffered massive, sudden shocks due to internal and external manipulation and attack, including cyber-attack;¹² stablecoin arrangements

⁸ Circle, "USDC: the world's leading digital dollar stablecoin" (available at: <https://www.circle.com/en/usdc>).

⁹ See Sergio Goschenko, "Facebook's Novi Launches Pilot Program in Guatemala and US Using Pax Dollar, Bitcoin.com (Oct. 20, 2021) (available at: <https://news.bitcoin.com/facebooks-novi-launches-pilot-program-in-guatemala-and-us-using-pax-dollar/>) (noting that Facebook's digital wallet Novi will be initiating a pilot program using the Pax Dollar, with Coinbase serving as a custodian, and that although Diem is not being used as a transactional asset for the pilot the intention is for Diem to be used by Novi in the future); *and* LinkedIn post of David Marcus (Oct. 19, 2021) (stating that the Pax Dollar would be used in the pilot to "focus on testing [Facebook's] systems" and that the company "intend[s] to launch Novi with Diem once it receives regulatory approval and goes live") (on file with The Clearing House). See *also* Bank for International Settlements, "Stablecoins: risks, potential and regulation," BIS Working Paper No 905 (Nov. 2020) (available at: <https://www.bis.org/publ/work905.pdf>), pp. 9-13 (discussing actions taken by Facebook and their significance).

¹⁰ The G20, for example, has undertaken a study of the risks to the international monetary system presented by stablecoins. See G20, "Assessing the impact of stablecoins on the international monetary system: G20 and IMF to study the impact of Facebook's Libra project," G20 Insights (Dec. 10, 2020) (available at: https://www.g20-insights.org/policy_briefs/assessing-the-impact-of-stablecoins-on-the-international-monetary-system-g20-and-imf-to-study-the-impac-of-facebooks-libra-project/).

¹¹ See, for example, "Cryptocurrency project Basis to shut down and return funding to investors," Reuters (Dec. 13, 2018) (noting that a project to launch a stablecoin called "Basis" was shutting down after soliciting over \$133 million in investments); *and* Tomio Geron and Yuliya Chernova, "'Stablecoin' Project Basis Is Shutting Down After Raising \$135 Million," The Wall Street Journal (Dec. 13, 2018) (available at: <https://www.wsj.com/articles/stablecoin-project-basis-is-shutting-down-after-raising-135-million-11544730772>).

¹² See Arjun Kharpal and Ryan Browne, "Hackers return nearly half of the \$600 million they stole in one of the biggest crypto heists," CNBC (Aug. 11, 2021) (noting that \$33 million of Tether was part of a successful hacking of Poly Network, a platform that connects different blockchains together); *and* Yael Bizouati-Kennedy, "Stablecoin SafeDollar Crashes to \$0 Following Cyberattach," GOBankingRates.com (June 29, 2021) (available at: <https://www.yahoo.com/now/stablecoin-safedollar-crashes-0-following-122357249.html>). See *also* U.S. Securities and Exchange Commission, "Investor Alert: Bitcoin and Other Virtual Currency Investments" (May 7, 2014) (available at: https://www.sec.gov/oiea/investor-alerts-bulletins/investoralertsia_bitcoin.html) (noting the risk that crypto currency exchanges may stop operating or permanently shut down due to fraud, technical glitches, hackers or malware); *and* Roxanne Henderson and Loni Prinsloo, "South African Brothers Vanish, and So Does \$3.6 Billion in Bitcoin," Bloomberg (June 23, 2021) (available at: <https://www.bloomberg.com/news/articles/2021-06-23/s-african-brothers-vanish-and-so-does-3-6-billion-in-bitcoin>) (detailing an investigation into the founders of cryptocurrency exchange AfriCrypt after assets went missing from the platform).

have been found to have made material misrepresentations about backing/reserve status;¹³ and stablecoin arrangements have suffered from developmental difficulties and design challenges.¹⁴

Panics resulting from any such stablecoin-related event occurring in the future, or from adverse economic conditions, could have grave consequences, particularly given the susceptibility of stablecoins to runs and the facts that stablecoin issuers today generally do not have ready access to sources of liquidity and are not subject to capital requirements.¹⁵ Runs on stablecoin arrangements, or stress in stablecoin-based systems, could easily spillover into the insured banking system or the payment systems. In many instances, stablecoin issuers offer accounts that look like financial institutions' transaction accounts, and accept central bank money or commercial bank money in exchange for stablecoins. Depositors of insured financial institutions may not understand the difference between those systems that store value in, or enabling transactions in, insured commercial bank money, versus systems utilizing uninsured stablecoins. Likewise, end-users of stablecoins may not appreciate that stablecoin issuers and arrangements are generally not subject to any form of robust supervision or examination. The absence of robust supervision and examination of stablecoin issuers and arrangements means that matters routinely addressed in the supervision and examination processes of financial institutions - matters such as capital and liquidity, operational risk, data security, data privacy, and anti-money-laundering and sanctions compliance - may be left unaddressed, resulting in stablecoin end-users being exposed to the resultant risks.

¹³ See "In the Matter of Investigation by Letitia James, Attorney General of the State of New York, of iFinex Inc., BFXNA Inc., BFXWW Inc., Tether Holdings Limited, Tether Operations Limited, Tether Limited, Tether International Limited," settlement agreement (Feb. 18, 2021), pp. 3-13 (available at:

https://ag.ny.gov/sites/default/files/2021.02.17_-_settlement_agreement_-_execution_version.b-t_signed-c2_oag_signed.pdf) (finding that material misrepresentations had been made about the backing of Tether). See also Zeke Faux, "Anyone Seen Tether's Billions?" Bloomberg (Oct. 7, 2021) (available at: <https://www.bloomberg.com/news/features/2021-10-07/crypto-mystery-where-s-the-69-billion-backing-the-stablecoin-tether>) (examining Tether's backing, as well key officers of Tether).

¹⁴ See Nivesh Rustgi, "Algorithmic Stablecoin Crashes 50% as Devs Scramble for a Fix," Crypto Briefing (Apr. 7, 2021) (available at: <https://cryptobriefing.com/algorithmic-stablecoin-crashes-50-devs-scramble-fix/>) (noting that the algorithmic stablecoin FEI suffered price instability due to a protocol mishap, forcing holders to choose between a reduced value holding (a "lower peg value") and accepting a penalty of 50% for exchanging their FEI). See also Dr. Ryan Clements, "Built to Fail: The Inherent Fragility of Algorithmic Stablecoins," 11 Wake Forest L. Rev. Online 113 (Oct. 25, 2021) (available at: <http://www.wakeforestlawreview.com/2021/10/built-to-fail-the-inherent-fragility-of-algorithmic-stablecoins/>) (noting that algorithmic stablecoins have inherent design flaws that make them unstable).

¹⁵ See Gary B. Gorton and Jeffery Y. Zhang, "Taming Wildcat Stablecoins" (Sept. 30, 2021) (available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3888752) (noting that privately produced monies, including stablecoins, are "not an effective medium of exchange because they are not always accepted at par and are subject to runs"); and Jeanna Smialek, "Why Washington Worries About Stablecoins," The New York Times (Sept. 17, 2021) (available at: <https://www.nytimes.com/2021/09/17/business/economy/federal-reserve-virtual-currency-stablecoin.html>) (noting that regulators and policymakers in the US are concerned about the risks posed by stablecoins and stablecoin arrangements). See also US Department of the Treasury, "Readout of the Meeting of the President's Working Group on Financial Markets to Discuss Stablecoins" (July 19, 2021) (available at: <https://home.treasury.gov/news/press-releases/jy0281>) (noting that working group members discussed, in particular, "potential risks to end-users, the financial system, and national security").

The disruption or failure of a systemically important stablecoin arrangement could pose financial stability risks. Although no single stablecoin arrangement has yet achieved the size and scale to pose such a risk, The Clearing House agrees with the Financial Stability Board's assessment that a global stablecoin with reach and adoption across multiple jurisdictions, and substantial volume, could pose financial stability risks.¹⁶ The Clearing House believes that the proposed guidance will enhance financial stability and help to ensure that financial systems are protected from the potential failure of systemically important stablecoin arrangements.

Distributed networks have the potential to enhance the resilience and business continuity of the system, and could reduce or potentially eliminate the dependency on a single centralised operator, provided adequate governance and back-up arrangements are put in place. However, they present a different structure than the current centralized view of functions and risks. Therefore, further consideration should be given to how to ensure resilience and integrity of the system given decentralization of functions and service provision, which could include transition or portability provisions in case of failure of one of the nodes or issuers. The decentralized nature of the network requires as well further consideration on the application of the principles, in particular the one related to governance

Finally, at least in the United States, stablecoin arrangements are unlike existing payments systems, where even non-systemically important systems have meaningful regulatory and supervisory frameworks that apply.¹⁷ Because there is no comprehensive existing regulatory and supervisory framework for stablecoins in the United States,¹⁸ or in many other jurisdictions and because stablecoin

¹⁶ Financial Stability Board, "Addressing the regulatory, supervisory, and oversight challenges raised by 'global stablecoin' arrangements," Consultative Document (Apr. 14, 2020), pp. 7 & 13-14 (available at: <https://www.fsb.org/wp-content/uploads/P140420-1.pdf>) (noting that "attribute global refers to a stablecoin with a potential reach and adoption across multiple jurisdictions and the potential to achieve substantial volume, thus posing financial stability risks, rather than a specific legal or regulatory concept"). See also Financial Stability Board, "Regulation, Supervision and Oversight of 'Global Stablecoin' Arrangements," Final Report and High-Level Recommendations (Oct. 13, 2020), pp. 9 & 12-13 (available at: <https://www.fsb.org/wp-content/uploads/P131020-3.pdf>).

¹⁷ See, e.g., Bank Service Company Act, 12 U.S.C. §1861, *et. seq.* It should be further noted that supervisory oversight may also extend to such systems where national banks are investors in them as a condition to regulatory approval of such investment.

¹⁸ Some states in the U.S. with laws and regulations crafted for payments services, such as money-transmitter licensing laws/regulations, might apply those laws/regulations to stablecoins, particularly where stablecoins are provided to consumers and are capable of serving as a means of payment. See Danny Nelson, "FinCEN: Stablecoin Issuers Are Money Transmitters, No Matter What," CoinDesk (Nov. 19, 2019) (available at: <https://www.coindesk.com/policy/2019/11/19/fincen-stablecoin-issuers-are-money-transmitters-no-matter-what/>) (noting that then-FinCEN Director Kenneth Blanco gave remarks in which he opined that stablecoins are money transmitters when they function as such). In addition, some states have begun implementing special licensing requirements that apply to digital-currency-focused money transmission businesses, potentially including certain types of stablecoin arrangements. See New York State Department of Financial Services, "Virtual Currency Businesses" (available at: https://www.dfs.ny.gov/apps_and_licensing/virtual_currency_businesses); State of Nevada, Department of Business and Industry, Financial Institutions Division, "Nevada Financial Institutions Division statement on regulation of cryptocurrency in Nevada" (Aug. 19, 2019) (available at: <https://fid.nv.gov/uploadedFiles/fidnvgov/content/Home/features/FID%20Statement%20on%20Cryptocurrency.pdf>); and Wyoming Division of Banking, "Special Purpose Depository Institutions" (available at:

arrangements have the ability to scale rapidly, it will be important to identify early those stablecoin arrangements that have the *potential* to become systemically important and to apply the Principles to them, rather than waiting for actual systemic importance.¹⁹ Only through such proactive action can the regulatory community assure that the financial system will be adequately protected.

II. Discussion of Proposed Guidance

The Consultative Report sets forth proposed guidance on the application of the Principles to stablecoin arrangements, focusing on criteria for when stablecoin arrangements are considered financial market infrastructures for purposes of applying the Principles. The Consultative Report further analyzes the notable and novel features of stablecoin arrangements compared with existing FMIs and notes how such features may present challenges for compliance. These notable features include (a) the potential use of settlement assets that are neither central bank money nor commercial bank money and carry additional financial risk; (b) the interdependencies between multiple stablecoin arrangement functions, (c) the degree of decentralization of operations and/or governance, and (d) a potentially large-scale deployment of emerging technologies such as distributed ledger technology.²⁰ The Clearing House supports full application of and conformance with the Principles for stablecoin arrangements that are or are likely to become systemically important regardless of the challenges certain design choices may impose.²¹ Although the report provides proposed guidance on only a subset of principles, a systemically important stablecoin arrangement primarily used for making payments would be expected to observe all of the relevant principles including those principles for which no further proposed guidance is provided in the report. In particular, regulators should address the credit and liquidity risks associated with stablecoin arrangements by ensuring that stablecoin issuers maintain appropriate levels of capital and that the assets backing stablecoin arrangements are subject to appropriate standards concerning credit quality and liquidity.

<https://wyomingbankingdivision.wyo.gov/banks-and-trust-companies/special-purpose-depository-institutions>) (detailing state laws and regulations that might be applied to stablecoin arrangements, depending on the characteristics and function of those arrangements).

¹⁹ See, e.g., President's Working Group on Financial Markets, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency, "Report on Stablecoins" (Nov. 2021) (available at: https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf), at p. 2 (noting that "there are key gaps in prudential authority over stablecoins used for payments purposes.")

²⁰ "Application of the Principles for Financial Market Infrastructures to stablecoin arrangements," note 2, p. 4.

²¹ Application of the PFMI to stablecoin arrangements would have ancillary benefits as well, such as the application of disclosure standards to stablecoin arrangements. See "Report on Stablecoins," note 19, at pp. 10-11 (noting that the absence of requirements for clear and complete disclosures for stablecoin arrangements risks misleading disclosures being made in the marketplace); and Committee on Payment and Settlement Systems and Technical Committee of the International Organization of Securities Commissions, "Principles for financial market infrastructures" (April 2012) (available at: <https://www.bis.org/cpmi/publ/d101a.pdf>), at pp. 121-123, Principle 23 (requiring disclosure of sufficient information "to enable participants to have an accurate understanding of the risks, fees, and other material costs they incur by participating in the FMI," as well as the disclosure of "all relevant rules and key procedures").

A. CPMI-IOSCO Should Clarify That Stablecoin Arrangements That Do Not Conform To The Principles Bear The Risk Of Being Prohibited If They Are Or Are Likely To Become Systemically Important

The proposed guidance makes clear that stablecoin arrangements “can be designed and organized in a variety of ways.”²² Implicit in such statement is the understanding that designers have the ability to design stablecoin arrangements to conform to the Principles, or can choose not to conform. While the Consultative Report provides proposed guidance on what steps stablecoin arrangements should take to conform to the Principles, it should go further and make clear that stablecoin arrangements that are not designed in compliance with the Principles will bear the risk of being prohibited if they are, or are likely to become, systemically important. Such clarity would have the beneficial effect of encouraging early conformance by stablecoin arrangements, whether systemically important or not, with the Principles, thereby alleviating the risk that a stablecoin arrangement will attract significant usage and then have to convert operations to conform. Such late stage conversion could itself trigger potentially consequential disruptions to the stablecoin arrangement’s service, its users, and the market. Clarity in spelling out the potential consequences of various design choices would also clearly communicate the consequences of failing to meet regulatory expectations, which may be important to drive compliance.

B. Applicability of Principles & Determining Systemic Importance

The Consultative Report notes that in order “to be useable as a means of payments and/or store of value” stablecoin arrangements typically perform “three core functions: (i) issuance, redemption and stabilization of the value of the coins; (ii) transfer of coins []; and (iii) interaction with coin users for storing and exchanging coins” and that in some stablecoin arrangements “all three functions are conducted by a single entity, while in others the functions are unbundled...”²³ Noting that the Principles define a financial market utility as “a multilateral system among participating institutions, including the operator of the system, used for the purposes of clearing, settling, or recording payments, securities, derivatives or other financial transactions,” the Consultative Report goes on to state that a stablecoin arrangement that performs a transfer function should be considered a financial market utility for purposes of applying the Principles.²⁴ The Consultative Report concludes that since stablecoin arrangements “are primarily used for making payments, the principles that apply to payment systems ... will apply in their entirety to [stablecoin arrangements] performing a transfer function based on a functional approach (‘same business, same risks or risk profile, same rules’).”²⁵ The Clearing House is fully supportive of this approach as being necessary to protect the financial system from the risks posed by stablecoin arrangements, which can mirror the risks posed by other financial market infrastructures. The Clearing House also believes that the proposed guidance clearly articulates when stablecoin arrangements should be considered financial market infrastructures for purposes of applying the Principles.

²² *Id.* at p. 9

²³ *Id.* (quoting FSB reports).

²⁴ *Id.* (quoting the PFMI).

²⁵ *Id.*

The proposed guidance also sets forth certain considerations for determining the systemic importance of a stablecoin arrangement. The considerations include the size of the stablecoin arrangement, the nature and risk profile of the stablecoin arrangement's activity, the interconnectedness and interdependencies of the stablecoin arrangement, and the substitutability of the stablecoin arrangement.²⁶ Further detail is given in the proposed guidance for each consideration.²⁷ The proposed guidance goes on to note that "[a]t their discretion, authorities may consider the potential growth and future state of [a stablecoin arrangement] in determining the systemic importance of [a stablecoin arrangement] that is under development."²⁸

The Clearing House believes that the proposed guidance generally captures the relevant considerations that should be used to determine whether or not a particular stablecoin arrangement is systemically important. The Clearing House further believes, however, that the proposed guidance should be improved by adding a further consideration – namely, whether or not there is an appropriate existing regulatory and supervisory structure in place applicable to stablecoin arrangements that are not systemically important. In most jurisdictions, the early determination of whether or not a particular financial market utility is systemically important is less critical because there are already regulatory and supervisory frameworks in place that are deemed adequate to protect the financial system from the potential failure of the particular financial market utility that has not yet reached systemic importance.²⁹ In many jurisdictions, however, no such framework is in place for stablecoins.³⁰ In the United States, no comprehensive regulatory and supervisory framework exists, and there are significant gaps in existing regulatory authority.³¹ This means that the early determination of the potential systemic importance of a stablecoin arrangement will be substantially more important in terms of protecting the financial system from the potential consequences of a stablecoin arrangement's failure. Therefore, the Clearing House recommends that the guidance be revised so that authorities in their evaluation of the nature and risk profile of a stablecoin arrangement take into account whether or not there is a sufficient, existing regulatory framework in place to appropriately address the risks posed.

In addition, The Clearing House recommends that the guidance be further revised to eliminate the "discretion" to consider the potential growth and future state of a stablecoin arrangement and affirmatively require such consideration. A key risk associated with stablecoin arrangements is their ability to scale rapidly due to network effects or relationships between stablecoins and existing user bases or platforms.³² Given the potential for rapid growth, the early identification of stablecoin arrangements that are likely to become systemically important is vital to protecting the financial system. The identification of a stablecoin arrangement that has already become systemically important may be

²⁶ *Id.* at pp. 11-12.

²⁷ *Id.* at pp. 13-20.

²⁸ *Id.* at p. 12.

²⁹ *See supra* notes 17 & 19.

³⁰ *See* "Report on Stablecoins," note 19, p. 15 (noting the need for a "consistent and comprehensive" regulatory framework to address gaps in existing regulatory authority).

³¹ *See supra* note 18 (noting state laws and regulations that primarily focus on the money transmission function of digital-currency-related activities, and which might include licensure, but which generally do not impose the rigorous supervision, limitations on commercial activity, and other requirements commonly applied to entities engaged in payment-related activities in the U.S., such as instrument issuance); *see also* "Report on Stablecoins," note 19, p. 15 (noting gaps in the U.S. regulatory framework).

³² *Id.* at p. 2.

too late in that systemic risks associated with the stablecoin arrangement will already be present in the ecosystem and, further, changes the stablecoin arrangement may have to make to come into conformance could themselves create shocks to the financial system.

C. Governance

The Consultative Report notes that certain stablecoin arrangement models may face challenges in seeking to observe the Principles requirements regarding governance.³³ These challenges include the use of partial or fully decentralized governance, the use of governance implemented solely through software, which may be inflexible in the case of a changing environment, and interdependencies between the stablecoin arrangements' transfer function and other stablecoin arrangement functions that may be subject to different governance.³⁴ The guidance concludes, however, that systemically important stablecoin arrangements must nonetheless have appropriate governance arrangements that conform to the Principles, including an ownership structure and operation that "allow for clear and direct lines of responsibility and accountability."³⁵

The Clearing House believes that the proposed guidance is clear and actionable and sets forth the expectation that stablecoin arrangements that are systemically important must make design choices that conform to the requirements of the Principles, regardless of the ability to make other design choices. A financial market infrastructure's governance arrangements are critical to fulfilling the objectives of the Principles, including protecting the safety and efficiency of the financial market infrastructure, supporting the stability of the broader financial system, other relevant public interest considerations and the objectives of relevant stakeholders. Clear and effective governance is also essential to meeting other aspects of the Principles, such as the Board's responsibility to establish and oversee a clear, documented risk management framework.³⁶ Therefore, regardless of the challenges that stablecoin arrangements may face if they made certain design choices, it should be incumbent on stablecoin arrangements that are systemically important to make design choices that conform to the Principles.

D. Interdependencies

The Consultative Report notes that Principle 3 "aims to promote an integrated and comprehensive view of [financial market utility] risks" and that financial market infrastructures must have a "sound risk-management framework for comprehensively managing legal, credit, liquidity, operational and other risks."³⁷ The Report further notes that Principle 3 requires a financial market infrastructure to "regularly review the material risks it bears from and poses to other entities ... as a result of interdependencies and develop tools to address them."³⁸ The Report concludes that a stablecoin arrangement may face particular challenges in the management of material risks because of the multiple interdependent

³³ "Application of the Principles for Financial Market Infrastructures to stablecoin arrangements," note 2, pp. 13-14.

³⁴ *Id.*

³⁵ *Id.* at p. 14.

³⁶ See "Principles for financial market infrastructures," note 21, at p. 28, § 3.2.8, and pp. 32-35.

³⁷ "Application of the Principles for Financial Market Infrastructures to stablecoin arrangements," note 2, p. 14.

³⁸ *Id.* at pp. 5 & 14-15.

functions that a stablecoin arrangement may perform, with the transfer function being subject to the Principles and other functions, such as issuance, redemption, stabilization and interaction with coin users for storing and exchanging coins not being subject to the principles.³⁹ Further, while all functions may be performed in a single entity, they may also be unbundled, with different functions being performed by different entities potentially subject to different governance arrangements.⁴⁰

The proposed guidance makes clear that regardless of the design choices inherent in a particular stablecoin arrangement, a stablecoin arrangement that is systemically important must still fully conform to the requirements of Principle 3, including regularly reviewing the material risks that the financial market infrastructure function bears from and poses to other stablecoin arrangement functions and entities and, further, that it must develop appropriate risk-management frameworks and tools to address these risks.⁴¹ The Clearing House believes the proposed guidance is sufficiently clear and actionable to inform stablecoin arrangements of the need to comprehensively manage risks from other stablecoin arrangement functions and entities and their interdependencies.

E. Settlement Finality

The Consultative Report notes that Principle 8 defines settlement as “the irrevocable and unconditional transfer of an asset or financial instrument, or the discharge of an obligation by the [financial market infrastructure] or its participants in accordance with the terms of the underlying contract” and further notes that the “clarity and certainty of settlement finality is critical for mitigating settlement risk.”⁴² The Consultative Report identifies stablecoin arrangements that have a design feature allowing for “probabilistic settlement” as potentially facing difficulties complying with Principle 8 in that, although legal finality is thought to be achieved, a “fork” may cause technical settlement to be reversed.⁴³

The proposed guidance makes clear that a systemically important stablecoin arrangements should provide clear and final settlement, regardless of the operational settlement method used. Specifically, when seeking to observe Principle 8, a systemically important stablecoin arrangement must clearly define the point at which a transfer on the ledger becomes irrevocable and technical settlement happens, make it transparent whether and to what extent there could be a misalignment between technical settlement and legal finality, ensure proper transparency regarding mechanisms for reconciling the misalignment between technical settlement and legal finality and have measures in place to address the potential losses.⁴⁴

Providing appropriate clarity and certainty regarding settlement finality is critical to mitigating settlement risk, which in turn can lead to systemic risk. The Clearing House believes that the proposed guidance on settlement finality is sufficiently clear and actionable to inform how stablecoin arrangements will need to manage risks arising from a misalignment between technical and legal finality and appropriately require stablecoin arrangements to address the issue of settlement risk.

³⁹ *Id.* at p. 15.

⁴⁰ *Id.* at pp. 9 & 12-15.

⁴¹ *Id.* at pp. 5 & 14-15.

⁴² *Id.* at p. 15.

⁴³ *Id.* at p. 16.

⁴⁴ *Id.*

F. Money Settlements

The Consultative Report notes that Principle 9 sets forth certain expectations for the settlement assets of a financial market infrastructure, including that a financial market infrastructure should “conduct its money settlements in central bank money where practical and available” and that if central bank money is not used, a financial market infrastructure “should minimize and strictly control the credit and liquidity risk arising from the use of commercial bank money.”⁴⁵ While many participants in a stablecoin arrangement may not have access to central bank money, we understand the standard to provide flexibility to participants to use other methods where credit and liquidity risk are properly controlled and that CPMI is not suggesting that central banks change their standards for granting access to central bank accounts to otherwise accommodate stablecoin arrangements. The Clearing House is supportive of this approach.

The Consultative Report goes on to note that certain stablecoin arrangements may be challenged in complying with the requirements of Principle 9 in that use of the stablecoin as the settlement asset can subject participants to the credit and liquidity risks of the stablecoin itself, the issuer of the stablecoin, and/or the settlement institution.⁴⁶ This may in turn “result in a greater amount of risk than ‘little to no’ credit and liquidity risk and may not enable the [financial market infrastructure] and its participants to readily transfer their assets into other liquid assets, such as claims on a central bank.”⁴⁷ The Consultative Report further notes that, while stablecoins may be backed with underlying funds, securities, or other assets, the “manner and extent to which the reserve assets serve as backing depends on the design and associated contractual arrangements of the stablecoin in question as well as applicable law.”⁴⁸ Participants may also be “exposed to credit risk if a stablecoin loses value relative to the sovereign currency in which it is denominated or to which it is pegged or if the issuer of the stablecoin defaults on its obligations to the participant.”⁴⁹ The Consultative Report also notes that stablecoins may be vulnerable to “run risk” if the reserve assets are “insufficient or cannot be liquidated at or close to market values in a timely manner when needed.”⁵⁰

The proposed guidance aligns with the core requirements of Principle 9 in specifying that a stablecoin used by a systemically important stablecoin arrangement “should have little or no credit or liquidity risk.”⁵¹ The proposed guidance further specifies that a systemically important stablecoin arrangement should determine whether the credit and liquidity risks of the stablecoin are minimized and strictly controlled such that it is an acceptable alternative to the use of central bank money and outlines various factors for consideration.⁵²

⁴⁵ *Id.* at p. 17.

⁴⁶ *Id.*

⁴⁷ *Id.* at p. 18.

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ *Id.* at p. 19.

⁵¹ *Id.*

⁵² The factors enumerated include: the clarity and enforceability of legal claims, the nature and sufficiency of the stablecoin arrangements reserve assets, the clarity, robustness and timeliness of the process for covering the stablecoin into other liquid assets, the creditworthiness, capitalization, access to liquidity and operational reliability of the issuer, the sufficiency of the regulatory and supervisory framework that applies to the issuer, reserve managers and or custodians, and the existence of risk controls that could reduce credit and or liquidity risks. (*Id.* at p. 20.)

The limitation of credit and liquidity risk relating to the settlement assets used by a financial market infrastructure is key to limiting credit and liquidity risk within the financial system and the inherent systemic risk that systemically important financial market infrastructures may pose. Accordingly, The Clearing House supports the application of Principle 9 to stablecoin arrangements and believes the guidance provided is sufficiently clear and actionable so as to inform stablecoin arrangements how to manage risks associated with the use of a stablecoin as a settlement asset.

While supportive of the application of Principle 9 to stablecoin arrangements, The Clearing House is also concerned that the proposed guidance relating to Principle 9 focuses too narrowly on the stablecoin itself and as a result only addresses *some* of the risks that CPMI-IOSCO has identified regarding money settlements. As CPMI-IOSCO notes, risks may arise not only from the stablecoin itself, but settlement in non-central bank money can also subject participants to the credit and liquidity risks of the “issuer of the stablecoin, and/or the settlement institution.”¹ The Clearing House believes that a more prescriptive approach is needed. Specifically, The Clearing House recommends that CPM-IOSCO include in the guidance a requirement that when settlement is conducted with a stablecoin instead of central bank money, the issuer of that stablecoin needs to 1) be a bank or other appropriately regulated financial institution, or 2) deposit the funds at a bank or other financial institution that is appropriately regulated, supervised and has sufficient controls in place to manage the risks arising from the stablecoin arrangement.

III. Conclusion

The risks relating to stablecoins are significant and have the ability to threaten the stability of the financial system. The rapid growth of stablecoin arrangements, their use as a payments vehicle, the transfer and issuance functions associated with them, inadequate capital and reserve requirements, unclear resilience and/or business continuity plans and the lack in many jurisdictions of meaningful regulatory and supervisory frameworks applicable to them, or of comprehensive frameworks, present unique risks that warrant full application of the Principles to such arrangements regardless of the challenges that certain design choices may present regarding conformance. Further, the ability of stablecoin arrangements to scale rapidly in combination with the unique risks they present warrants early identification of and full application of the Principles to those stablecoin arrangements that are likely to become systemically important. We appreciate the important work that CPMI-IOSCO is doing in this area and look forward to the international regulatory community moving forward to address the risks that have been highlighted.

Respectfully submitted,

/s/

Robert C. Hunter
Deputy General Counsel & Director of Regulatory and Legislative Affairs

^[1] *Id.* at p. 17.