April 15, 2022

Skadden

# The Distributed Ledger

## Blockchain, Digital Assets and Smart Contracts

If you have any questions regarding the matters discussed in this memorandum, please contact the attorneys listed on the last page or call your regular Skadden contact.



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*This is the fifth in a series of articles in which we discuss recent efforts by U.S. regulators and other bodies to set expectations and standards with respect to cryptocurrencies and other virtual assets and the impact of these efforts on businesses engaged in virtual asset activities. Read the series.*

### Toomey Introduces Proposal for Payment Stablecoin Regulatory Framework

On April 6, 2022, Sen. Pat Toomey (R-Pa.), the ranking member of the Senate Banking Committee, and an advocate for clarity in cryptocurrency regulations, released a discussion draft of legislation that would provide a regulatory framework for the issuance of payment stablecoins. Sen. Toomey's proposal defines a payment stablecoin as a convertible virtual currency that is designed to maintain a stable value relative to a fiat currency or currencies; is convertible directly to fiat currency by the issuer; is designed to be widely used as a medium of exchange; is issued by a centralized entity; does not inherently pay interest to the holder; and is recorded on a public distributed ledger.

Sen. Toomey's discussion draft would authorize three different options for issuance of payment stablecoins and would subject all issuers to standardized disclosure, redemption and attestation requirements. It also provides that payment stablecoins that do not offer interest would not be securities.

Although the legislative prospects for the proposal are uncertain, it has attracted attention as an alternative to the approach suggested by the President's Working Group on Financial Markets (PWG) in its Report on Stablecoins, issued on November 1, 2021. See November 16, 2021, client alert, "Federal Regulators Move To Regulate Stablecoins Through Banking Laws Plus New Legislation."

#### Payment Stablecoin Issuances

The Toomey proposal would authorize issuance of payment stablecoins by (1) "national limited payment stablecoin issuers," (2) insured depository institutions, and (3) money transmitting businesses, or any other persons that are authorized by a state banking or similar authority to issue stablecoins. All other payment stablecoin issuances would be prohibited.

### 1. National Limited Payment Stablecoin Issuers

Sen. Toomey's proposal would authorize the Office of the Comptroller of the Currency (OCC) to charter national limited payment stablecoin issuers (NLPSIs) that would have the power to issue and redeem payment stablecoins and engage in any activities incidental to that, including making a market in such stablecoins and holding and managing the reserve assets behind them. Although an NLPSI would not be permitted to engage in activities such as making loans or other extensions of credit, it would be eligible for Federal Reserve accounts and services.

The discussion draft would require the OCC to grant applications for NLPSI licenses within 90 days of submission, unless the OCC determines that the activities of the applicant would be unsafe or unsound. In making that determination, the OCC would be allowed to consider only (1) the financial condition and business plan of the applicant, (2) the general character and fitness of the management of the applicant, and (3) the risks presented and the potential benefits that could be delivered to consumers.

Sen. Toomey proposes to require payment stablecoins issued by NLPSIs to be backed with assets with a market value equal to at least 100% of the par value of the payment stablecoins outstanding. The assets would have to be cash or cash equivalents, or level 1 high quality liquid assets denominated in U.S. dollars. The discussion draft would generally limit the OCC's authority to promulgate regulations for national limited payment stablecoin issuers to (1) capital requirements not exceeding six months of operating expenses, (2) liquidity requirements, and (3) governance and risk management requirements tailored to the business model and risk profile.

Deposit insurance would not be required for payment stablecoins issued by a NLPSI, a departure from the PWG approach. However, fractional reserve stablecoins — stablecoins backed by less than 100% cash, cash equivalents or level 1 high quality liquid assets — would not be permitted for national limited payment stablecoin issuers.

### 2. Insured Depository Institutions

The second category of issuers authorized under the discussion draft would be insured depository institutions. The statutory authorities of traditional commercial banks would be expanded explicitly to allow them to issue payment stablecoins, and they would be permitted to segregate their issuance and the management of reserve assets in a legal entity separate from the institution's other activities. Insured depository institutions opting to issue payment stablecoins would be subject to the same tailored regulatory standards as NLPSIs for that activity, but would remain subject to full regulation, examination and supervision by their appropriate federal banking agency.

### 3. State-Regulated Entities

The third category of issuers authorized under the discussion draft would be money transmitting businesses or any other persons that are authorized by a state banking or similar authority to issue stablecoin. This provision would preserve the state-registered money transmitter status for most existing stablecoin issuers. These state-regulated entities would not be required to maintain particular reserves under the discussion draft, but would be subject to the discussion draft's disclosure, redemption and attestation requirements. This approach, which relies on transparency as its principal means for consumer protection, diverges from the PWG approach, which would limit issuances of payment stablecoin to insured depository institutions.

### Disclosure, Redemption and Attestation Requirements

The discussion draft would require that all issuers of a payment stablecoin (1) publicly disclose the assets backing the payment stablecoin on a monthly basis, (2) adopt and publicly disclose policies for redeeming the payment stablecoin, including whether redemption requests will be met on demand or with a time lag, (3) undergo quarterly attestations by an registered public accounting firm and publicly disclose the results, and (4) attest that the assets backing the payment stablecoin do not materially diverge from those disclosed. All issuers of a payment stablecoin would be required to file these disclosures with the Treasury Department for publication on online.

### Securities and Exchange Commission Regulation

Sen. Toomey proposes to bar the Securities and Exchange Commission (SEC) from regulating payment stablecoins that do not offer interest, including by changing the definitions of security in the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940 or the Investment Advisers Act of 1940. This provision is one of the first explicit proposals to limit the remit of the SEC in the area of cryptocurrencies.

### Privacy Protections for Convertible Virtual Currencies and Stablecoin Users

Under the proposed legislation, the Secretary of the Treasury would be prohibited from collecting or mandating the collection of nonpublic information about convertible virtual currency transactions unless (a) pursuant to a court-issued warrant based on a finding of probable cause that a crime has been committed or (b) voluntarily disclosed by a customer of a financial institution, business or other third party and held for a legitimate business purpose of that person.

In addition, NLPSIs would be subject to Title V of the Gramm-Leach-Bliley Act (15 U.S.C. § 6801 *et seq.*), which requires the Federal Trade Commission, federal banking agencies and other federal regulatory agencies to issue regulations ensuring that financial institutions protect the privacy of consumers' personal financial information. Those institutions would be required to develop and give notice of their privacy policies to their customers at least annually, and give notice and an opportunity for a consumer to "opt out" before disclosing any consumer's personal financial information to an unaffiliated third party.

### Legislative Prospects

The legislative prospects for Senator Toomey's discussion draft, and more broadly for payment stablecoin legislation, are uncertain this year. President Biden recently issued an executive order calling for a whole-of-government approach to addressing the risks and harnessing the potential benefits of digital assets. See March 10, 2022, client alert, "Executive Order Aiming To Coordinate Digital Assets Policies May Bring Much-Needed Clarity." In addition, Treasury Secretary Janet Yellen delivered a major address on the topic on April 7, 2022, so it is not clear that Congress will take action on digital assets this year.

Secretary Yellen stated that the Biden administration is "now working with Congress to advance legislation to help ensure stablecoins are resilient to risks that could endanger consumers or the broader financial system," but added that the Treasury Department will likely need six months to complete the "foundational reports and recommendations" called for in the executive order on digital assets. Based on this timetable, Congress would receive recommendations barely one month before the midterm elections, which could result in a change of control of the Senate, the House of Representatives, or both.

Until a new session of Congress begins in 2023, the decision to enact legislation will rest with the Biden administration and the Democratic chairs of the House and Senate banking committees. At present, both chairs have expressed significant concerns about stablecoins that may take time to address satisfactorily. Sen. Sherrod Brown (D-Ohio), chair of the Senate Banking, Housing and Urban Affairs Committee, has said, "We need a strong, proactive approach from regulators and Congress to limit stablecoins' risks for working Americans. As our economy continues to recover from COVID-19 — as workers are finally starting to see higher wages and more bargaining power in the workplace — the last thing we need is for a risky new financial product to cause disaster."

Representative Maxine Waters (D-Calif.), chair of the House Financial Services Committee, has said, "regulators and policymakers must work to ensure that any innovation in this space is responsible, that it provides robust consumer and investor protection, that it mitigates environmental impact, and that financial inclusion is front and center."

Given this landscape, it seems unlikely that any payment stablecoin legislation will advance this year, including Sen. Toomey's proposal. Nonetheless, the discussion draft, like the PWG report before it, provides an important framework for discussion as regulators consider the best approach to regulate and manage the burgeoning stablecoin sector. While they present different policy perspectives and solutions, both documents help advance the discussion and debate about the nature and scope of regulation and underscore the need for regulatory clarity, which is a prerequisite for broad-based integration of digital assets into the financial system.

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