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Comparison of Representatives McHenry's and Waters' stablecoin legislative proposals

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Introduction

- Representatives Patrick McHenry (R-NC) and Maxine Waters (D-CA), the respective Chair and Ranking Member of the House Financial Services Committee (HFSC), have been negotiating legislation to regulate the issuance and oversight of payment stablecoins.

  - A staff discussion draft that reflected some input from majority and minority staff was first made available in September 2022.

  - In a notice announcing a May 18, 2023 hearing on stablecoin legislation, the HFSC published a discussion draft of Rep. McHenry's proposed legislation and a discussion draft of Rep. Waters' proposed legislation (the Waters Bill). An updated discussion draft of Rep. McHenry's proposed legislation (the McHenry Bill) was subsequently issued in advance of a June 13, 2023 HFSC hearing on digital asset issues.

- Each bill has been subjected to multiple rounds of updates. The latest version of the McHenry Bill reflects a relatively greater degree of alignment with the Waters Bill and may be an attempt to achieve a bipartisan consensus on stablecoin legislation.

- While the path forward for bipartisan stablecoin legislation is unclear, on June 26, 2023 Rep. Jim Himes (D-CT), a key Democratic member of the HFSC, predicted that the committee was "very close" to agreement on a stablecoin bill.

- Rep. McHenry also published a discussion draft of digital asset market structure legislation with Rep. Glenn Thompson (R-PA), the Chair of the House Committee on Agriculture, on June 2, 2023 (the Market Structure Bill). The Market Structure bill grants the SEC anti-fraud and anti-manipulation enforcement authority over payment stablecoins when brokered, traded or custodied by an SEC-registered broker-dealer or alternative trading system, but provides that the SEC "shall have no authority over the design, structure, or operation of payment stablecoins."

- The following slides compare the latest versions of the McHenry Bill and the Waters Bill in advance of a potential July markup and committee vote on stablecoin legislation.

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Key definitions

Bill	Key defined terms	Securities classification	Tokenized deposits
McHenry Bill	**Payment stablecoin**. Defines "payment stablecoin" as a digital asset (A) that is or is designed to be used as a means of payment or settlement; (B) the issuer of which (i) is obligated to convert, redeem, or repurchase for a fixed amount of monetary value; and (ii) represents will maintain or creates the reasonable expectation it will maintain a stable value relative to the value of a fixed amount of monetary value; and (C) that is not a (i) national currency or (ii) a security issued by a registered investment company registered under section 8(a) of the Investment Company Act. **Distributed ledger**. The definition of distributed ledger refers only to "<u>public</u>" distributed ledgers. Because "digital asset" and "payment stablecoin" are each defined as digital assets recorded on "a cryptographically secured distributed ledger," it is unclear whether an asset recorded on a private, permissioned blockchain could fall within the definition of "digital asset" or "payment stablecoin."	**Expressly excluded**. Amends the definition of "security" under the federal securities laws to expressly exclude payment stablecoins.	**Out of scope**. Provides that nothing in the bill should be construed to prevent insured depository institutions from "accepting or receiving deposits and issuing digital assets that represent deposits" (i.e., tokenized deposits).
Waters Bill	**Payment stablecoin**. Same as the McHenry Bill's definition. **Distributed ledger**. Unlike the McHenry Bill, this definition is not limited to "public" distributed ledgers.	**Not addressed**. Silent on whether stablecoins are securities, other than defining stablecoins as not being securities issued by an investment company.	**Out of scope**. Same as McHenry Bill.

Overview of stablecoin legislative proposals

Bill	Registration types	Primary regulator	100% reserve	Reserve disclosure	Redemption	Priority of stablecoin holders over other creditors
McHenry Bill	— Subsidiary of IDI — Federally licensed nonbank — State-qualified	— OCC or FRB — OCC or FRB — **State regulator**	✓	✓	**"Timely"** redemption	✗
Waters Bill	— Subsidiary of IDI — Federally licensed nonbank — State-qualified **and FRB-registered**	— OCC or FRB — **FRB** — **FRB**	✓	✓	**One-day** redemption	✓

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Overview of stablecoin legislative proposals (cont.)

Bill	FDIC insurance	Master account or discount window access for nonbank issuers	Regulation of custodians and wallet providers	Regulation of service providers	Prohibition on affiliation with commercial entities	Interoperability requirement	Algorithmic stablecoin moratorium	Assessments on stablecoin issuers
McHenry Bill	✗	✗	✓	✗	✗	✓	✓	✗
Waters Bill	✗	✗	✓	✓	✓	✓	✓	✓

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Key observations

— Even if either of the Bills were enacted, it is unclear whether the federal banking agencies would permit IDI subsidiaries to issue payment stablecoins on public blockchains such as Ethereum—as is standard for existing stablecoins.

— The federal banking agencies have been growing increasingly critical of public, permissionless blockchains.

- In a January 2023 Joint Statement on Crypto-Asset Risks to Banking Organizations, the federal banking agencies stated "the agencies believe that issuing or holding as principal crypto-assets that are issued, stored, or transferred on an open, public, and/or decentralized network . . . is highly likely to be inconsistent with safe and sound banking practices."

- In its Order denying Custodia Bank, Inc.'s (Custodia) application to become a member in the Federal Reserve System, the FRB discussed a number of significant concerns related to Custodia's planned issuance of Avits, which the FRB deemed to be the functional equivalent of stablecoins. These concerns related to safety and soundness risks, illicit finance risks, operational risks, cybersecurity risks, run risks, consumer risks and monetary policy risks. Like many of the most widely used stablecoins, Avits would have been issued on the Ethereum blockchain.

- In June 16, 2023 remarks before the American Bar Association, Acting Comptroller of the Currency Michael J. Hsu stated that public blockchains "suffer from a key design flaw," are inefficient, can involve "ponzi-prone 'tokenomics,'" are "attractive to criminals and others engaged in illicit finance" and make "full compliance with anti-money laundering rules … extremely difficult."

— The McHenry Bill appears designed to constrain the federal banking agencies' discretion, but it is unclear if it would prevent a federal banking agency from denying an IDI subsidiary's application to issue payment stablecoins based on a general finding that payment stablecoin activities are unsafe or unsound.

— Although the Waters Bill does not explicitly include safety and soundness as one of the factors a federal banking agency shall consider when reviewing applications, it does include factors related to elastic concepts such as public benefits and financial stability. The Waters Bill also grants federal payment stablecoin regulators broad enforcement authority related to any practice deemed unsafe or unsound.

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Primary regulator

Bill	Primary regulator for the stablecoin issuer

McHenry Bill	— **Subsidiary of an IDI**. The insured depository institution's (**IDI**) federal banking regulator.
	
	— **Federal nonbank entity**.
	  ▪ Uninsured national trust bank: Office of the Comptroller of the Currency (**OCC**)
	  ▪ Any other federal nonbank entity: the Federal Reserve Board (**FRB**)
	
	— **State entity**. Appropriate state regulator, unless the state regulator has entered a supervisory agreement with the FRB that defers authority to the FRB. In the absence of a supervisory agreement, the FRB is provided back-up enforcement authority in "exigent circumstances."

Waters Bill	— **Subsidiary of an IDI**. Same as McHenry Bill. — **Federal nonbank entity**. FRB. — **State entity**. Primarily regulated by the FRB, secondarily regulated by state regulator.*

Key differences between the McHenry Bill and the Waters Bill:

1. Federal vs. state regulation of state stablecoin issuers. The McHenry Bill grants state regulators primary supervision, examination and enforcement authority over state stablecoin issuers, leaving the FRB with secondary, back-up enforcement authority, while the Waters Bill grants the FRB primary authority over state stablecoin issuers.

2. Primary regulator for federal nonbank stablecoin issuers. The McHenry Bill designates the OCC as the primary regulator for some federal nonbank stablecoin issuers (e.g., national trust banks) and the Waters Bill designates the FRB as the primary regulator of all federal nonbank stablecoin issuers.

*Under the Waters Bill, a state regulator may be consulted by the FRB regarding a state payment stablecoin issuer (for instance, with respect to a prospective state payment stablecoin issuer's application to the FRB).

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Reserve requirements

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Bill	Reserve composition	Reserve disclosures	Rehypothecation	Redemption
McHenry Bill	— Payment stablecoins must be backed on a 1:1 basis (i.e., issuer must maintain 100% reserve). — Eligible assets: U.S. currency (including Federal Reserve notes), insured deposits, Treasuries with maturities of 90-days or less (**short-term treasuries**), repurchase agreements backed by short-term treasuries, central bank reserve deposits, or other assets deemed appropriate by the federal payment stablecoin regulator.	— Payment stablecoin issuers must publish monthly reports attested to by the CEO or CFO disclosing the state of reserves. — **<u>Reports must be reviewed monthly and examined annually by a registered public accounting firm.</u>**	— Reserves may **<u>not</u>** be pledged, rehypothecated, or reused by payment stablecoin issuers, except that short-term treasuries may be pledged for repurchase agreements with a maturity of 90 days or less for the purpose of creating liquidity to meet reasonable expectations of requests to redeem payment stablecoins.*	— Issuers must have procedures to process **<u>timely</u>** redemptions.
Waters Bill	— Materially similar to McHenry Bill, except does not include catch-all for any assets deemed appropriate by the applicable federal payment stablecoin regulator.	— Same as McHenry Bill, except no requirement for monthly review or annual examination of reports by a registered public accounting firm.	— Same as McHenry Bill.	— Issuers must have procedures to process redemptions within **<u>one day</u>** of request.

* In such a case, the repurchase agreements must be cleared by a central clearing counterparty approved by the appropriate federal payment stablecoin regulator or the issuer must receive prior approval from the appropriate federal payment stablecoin regulator.

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Access to federal banking system

Bill	Deposit insurance	Access to Federal Reserve Master Account and Discount Window
McHenry Bill	✖	✖
Waters Bill	✖	✖

No key differences: In contrast to the September 2022 HFSC working draft, and certain other stablecoin legislative proposals, neither bill would grant nonbank issuers access to a Federal Reserve master account or the discount window. Neither bill nor any prior version would establish a deposit insurance scheme for payment stablecoins.

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Bank-like regulatory framework

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Elements of bank-like regulation included in both McHenry Bill and Waters Bill	Additional elements of bank-like regulation in Waters Bill
— **Capital, liquidity and risk management requirements**. The federal payment stablecoin regulators (i.e, FRB and OCC) have broad authority to impose capital, liquidity, and risk management requirements on stablecoin issuers.	— **Control systems**. Payment stablecoin issuers must maintain appropriate control systems to issue stablecoins in a safe and sound manner and in compliance with law.
— **Collins Amendment**. Neither bill explicitly addresses the Collins Amendment, which established minimum (non-risk sensitive) leverage capital ratios. It is not clear that either bill provides regulators with sufficient authority to reduce the potential negative capital implications on the IDI and its holding company of having a subsidiary that issues payment stablecoins.	— **Application of BHC Act restrictions**. Any IDI Subsidiary stablecoin issuer will be considered a "bank" for purposes of the Bank Holding Company Act of 1956 (**BHC Act**) and thus subject to BHC Act restrictions (with the exception of an insured depository institution that is a savings association for purposes of the Home Owners' Loan Act).
— **Bank Secrecy Act**. All payment stablecoin issuers are treated as financial institutions under the Bank Secrecy Act.	— **Regulation W**. The FRB must issue regulations applying affiliate transaction restrictions (i.e., Regulation W) and the BHC Act's activities restrictions to affiliates of federal nonbank and state payment stablecoin issuers.
— **Privacy**. Payment stablecoin issuers are subject to the Gramm-Leach-Bliley Act's (**GLBA**) customer privacy requirements, although under the McHenry Bill no provision explicitly applies these requirements to state stablecoin issuers (it is not clear such a provision is needed to apply the GLBA privacy requirements to a stablecoin issuer).	— **Change in control**. The appropriate federal payment stablecoin regulator must approve any person or group that acquires control of a payment stablecoin issuer, similar to the requirements of the Change in Bank Control Act.
— **Activities limits**. Issuers must limit their activities to issuing and redeeming payment stablecoins, managing related reserves, providing custodial and safekeeping functions, and other limited functions that directly support issuing and redeeming payment stablecoins.	— **Stablecoin holder priority in insolvency**. Stablecoin holders' claims against the payment stablecoin issuer are given priority over all other claims in the issuer's insolvency, much like bank depositors.

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Regulation of stablecoin ecosystem

Bill	Custodians and wallet providers	Payment stablecoin service companies
McHenry Bill	— Grants the FRB regulatory and supervisory authority over persons who engage in the business of providing custodial or safekeeping services for payment stablecoins or their private keys, if not otherwise subject to (i) the regulation of a primary financial regulatory agency (as defined in the Dodd-Frank Act) or (ii) a state bank supervisor that the FRB has determined has a comparable and equivalent framework for licensing, examination and supervisory processes.* — Such persons are subject to customer protection requirements related to asset segregation and a prohibition on commingling customer property. They are also required to take appropriate steps to protect customer property from creditor claims.** — Intends to overturn the SEC's Staff Accounting Bulletin 121 (**SAB 121**) for IDIs and affiliates of IDIs, but—in contrast to prior versions of the McHenry Bill—not for other payment stablecoin issuers. SAB 121 directs any public reporting company that custodies crypto-assets to record a liability on its balance sheet in the amount of the fair value of such crypto-asset.	— Does not directly address the regulation of payment stablecoin service companies engaged by payment stablecoin issuers.
Waters Bill	— Grants the FRB the same authority over payment stablecoin custodians and wallet providers as the McHenry Bill. — Does not include the FRB comparability determination requirement. — Does not address SAB 121.	— Permits the federal regulator of a payment stablecoin issuer to supervise any payment stablecoin service company engaged by that issuer to perform activities authorized under the Waters Bill or that are necessary to the functioning of a payment stablecoin. This provision of the Waters Bill resembles a provision of the Bank Service Company Act (12 U.S.C. § 1867(c)).

* Each Bill explicitly states that the FRB's authority does **not** extend to entities engaged in the business of facilitating self-custody, such as non-custodial wallet providers and decentralized finance (**DeFi**) protocols.
** Each Bill permits payment stablecoins, cash and other property of multiple customers to be commingled and deposited in an omnibus account at an IDI or trust company.

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Regulation of stablecoin ecosystem (cont.)

Bill	Interoperability standards	Moratorium on algorithmic stablecoins
McHenry Bill	— The federal payment stablecoin regulators (i.e., FRB and OCC) are provided authority to prescribe interoperability and compatibility standards for payment stablecoin issuers.	— Imposes a two-year moratorium on the issuance, creation or origination of "endogenously collateralized" (i.e., algorithmic) stablecoins not in existence on the date of enactment of the bill. Directs the U.S. Treasury, in consultation with other agencies, to produce a report to Congress on algorithmic stablecoins and other non-payment stablecoins within one year of enactment.
Waters Bill	— Same as McHenry Bill, but also specifies that interoperability standards may include mandatory or minimum technical or legal specifications that enable participants in one payment system to clear and settle payments across payment systems without participating directly in multiple payment systems.	— Same as McHenry Bill.

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Additional provisions in Waters Bill

Bill	Additional provisions
Waters Bill	— **Assessments on payment stablecoin issuers**. The federal banking agencies are required to recoup the costs of carrying out stablecoin issuer supervisory responsibilities through assessments on the issuers and to jointly issue rules regarding such assessments.
	— **CBDC study and briefing**. The FRB, in consultation with the other federal banking agencies and the Financial Crimes Enforcement Network (**FinCEN**), is required to issue a study on the impact of a U.S. central bank digital currency (**CBDC**) within one year of enactment. The U.S. Department of Treasury is required to brief Congress on the development of international standards related to CBDCs within 180 days of enactment.
	— **Diversity, equity, and inclusion (DEI)**. Federal banking agencies must promote DEI, including by requiring all stablecoin issuers to report certain DEI information and publish an annual report detailing DEI efforts.
	— **Criminal ownership prohibition**. Persons convicted of certain financial crimes generally are prohibited from serving as an executive officer or owning more than 5% of a payment stablecoin issuer.

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If you have any questions about the topics covered in this deck, please contact any of the lawyers listed above or your regular Davis Polk contact.

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