**Stablecoins: Background and Policy Issues**

Stablecoins are digital assets generally designed to maintain a stable value by linking the value to a national currency or other reference assets. The term *stablecoin* does not affirm that a particular coin actually achieves a stable value. Some consider terms such as private asset-linked tokens as better descriptors considering the nature of the instruments. The top four stablecoins by value (Tether, USD Coin, Binance USD, and Dai) reached around $128 billion in market capitalization as of November 10, 2021, according to CoinMarketCap.

Many stablecoins have different operational structures and reserve compositions (Figure 1). Reserve assets backing stablecoins could include fiat currencies, traditional financial assets, or other digital assets and algorithms. Many stablecoins at the current stage of development are primarily used for payments functions to facilitate digital asset trading and lending. Although stablecoins represent a small fraction (5%) of the digital asset industry’s total value, they facilitate more than 75% of trading on all digital asset trading platforms as of October 31, 2021. Stablecoin-related policy concerns include issues related to market integrity, investor protection, financial stability, monetary policy, payments, and illicit activity prevention.

![Figure 1. Stablecoin Reserve Composition](https://crsreports.congress.gov/Files/Publications/GFSR/2021/October/English/ch2.ashx)


**Functions and Structures**

Stablecoins’ use could find parallels in traditional payment systems, banking, or other forms of financial infrastructure service. In addition, stablecoins’ management and structuring of the reserve funds resemble existing practices at money market mutual funds (MMFs) and exchange-traded funds (ETFs).

**Stablecoins’ Investment Fund-Like Structure**

Stablecoins often have reserve asset portfolios that hold assets backing the coins’ values. Many industry observers and some regulators believe that the general processes involving stablecoins’ creation, distribution, and redemption and the mechanism of keeping the stablecoin price in line with the value of the reserve basket is similar to certain common types of investment structures, such as ETFs and MMFs, which are regulated by the Securities and Exchange Commission (SEC).

Some stablecoins’ perceived investment fund structure has captured congressional attention in recent years. For example, the Meta Platforms–backed stablecoin Diem (formerly known as Facebook-backed Libra) has attracted congressional inquiries since its announcement in 2019. At related congressional hearings, Facebook received multiple questions regarding whether Libra was an ETF and how it should be regulated. Facebook argued at the time that Libra was a payment tool instead of an investment vehicle because “you cannot use an ETF for payments” and believed it did not meet the legal criteria used to determine if a financial instrument is a security. In the ensuing years, the firm also launched its digital wallet pilot program (Novi) and paired it with USDP, an existing stablecoin from Paxos. Five Senators wrote a letter to Facebook in October 2021 to urge the company to “immediately discontinue your Novi pilot and to commit that you will not bring Diem to market.”

If a stablecoin were to be deemed an ETF or MMF (either through interpretation of the existing legal frameworks and SEC authorities or the creation of new frameworks and authorities through legislation), it would be required to comply with the SEC’s regulatory regime governing securities, investment advisors, and investment companies. In this case, SEC approval would be required to launch stablecoin projects.

**Stablecoins’ Money and Payment Features**

Some observers also consider stablecoins to offer parallels to money and payment systems. They view stablecoins as a new form of private money that closely resembles the “wildcat” banknotes of the mid-19th century. During the “wildcat” or “free banking” era (1837-1863), state-chartered banks issued their own currencies and sometimes refused to redeem the currency for precious metals as they had promised they would. This era ended with the National Bank Act of 1863, which established the Office of the Comptroller of the Currency (OCC) and charged it with responsibility for nationally chartered banks and a uniform national currency. When discussing stablecoins, some regulators reference the wildcat era, questioning the “long-term viability for five or six thousand private forms of...
money.” Some academic researchers argue that to function as money, the financial instrument must satisfy the “no-question-asked” principle (NQA), which requires the money to be accepted in a transaction without due diligence on its value. Stablecoins (in their current forms) appear to have challenges satisfying the NQA principles.

**How Stable Are Stablecoins?**
Stablecoins have attracted discussions regarding potential fraud and manipulation and the need for disclosure and transparency. The largest stablecoin, Tether ($74 billion in market value as of November 10, 2021), for example, was created in 2014 with the promise of a one-to-one backing with the dollar, its corresponding fiat currency. Reporters and market participants have been seemingly unable to verify Tether’s portfolio holdings. An investigation by the New York attorney general’s office subsequently revealed that it was not fully backed as advertised at all times, raising investor-protection concerns.

In addition to investor protection concerns for individual stablecoin holders, industry observers and regulators have voiced concerns about stablecoins’ potential systemic risk—that losses or instability of stablecoins could generate distress in other markets. Even without the influence of adverse market conditions, certain stablecoins have already displayed run-like behavior (e.g., a large number of investors withdrawing their investments simultaneously, which could potentially trigger negative feedback loops and contagion effects). For example, a run-like scenario already occurred in June 2021 involving stablecoin Iron and its reserve asset Iron Titanium token (Titan). Titan saw its price crash to near zero from around $60 within one day, and stablecoin Iron traded off the peg at $0.69. In addition, certain stablecoins, including the fourth-largest stablecoin, Dai, can be susceptible to the use of financial leverage, which could multiply risk and return and in turn draw financial stability concerns when used excessively.

In response to the rapidly developing conditions, the Financial Stability Oversight Council (FSOC) added stablecoins to its November 2021 meeting agenda, and the President’s Working Group on Financial Markets (PWG) published a report on stablecoins in November 2021.

**Applicable Stablecoin Regulation**

**Investment regulation.** Depending on design features and other factors, a particular stablecoin may legally be a security, commodity, and/or derivative and thus subject to federal securities laws (primarily implemented by the SEC) or the Commodity Exchange Act (primarily implemented by Commodity Futures Trading Commission [CFTC]). The SEC chairman said in a speech that stablecoins may be securities and investment companies that fall under the agency’s oversight. The CFTC has asserted its jurisdiction by taking enforcement actions against Tether for “making untrue or misleading statements and omissions of material fact.”

**Payment regulation.** The digital asset trading platforms stablecoins currently transact on are often state-registered enterprises called money transmitters. Money transmitters are subject to registration and reporting requirements from the Financial Crimes Enforcement Network (FinCEN), a bureau of the Treasury Department that implements the Bank Secrecy Act, the main federal anti-money-laundering law. For example, money transmitters are required to obtain and verify customer identity and record beneficiary information and file “Suspicious Activity Reports” for certain transactions. Some transactions are also subject to tax reporting. In addition, the Consumer Financial Protection Bureau may have a consumer protection role for certain stablecoin-enabled electronic payments.

**Custody regulation.** Some stablecoin companies have sought to be allowed to provide digital asset custody services by obtaining state and federal trust or custody bank charters. Custodians provide safekeeping of financial assets. They are financial institutions that do not have legal ownership of assets but are tasked with holding and securing assets, among other administrative functions. Both securities regulators and banking regulators have developed custody regulation to impose requirements designed to protect client assets from the possibility of being lost or misappropriated. The SEC’s custody rule obligates SEC-registered investment advisers to engage with “qualified custodians,” which could include banks. Aiming to fulfill such requirements, certain stablecoins have been issued by state-chartered trust companies. For example, stablecoins Binance Dollar and Paxos Dollar are issued by Paxos Trust Company, and the Gemini Dollar is issued by Gemini Trust Company. These stablecoin trust company issuers would have to comply with certain prudential supervision and examination requirements at the state level. Paxos has also reportedly received “preliminary conditional approval” for a U.S. national trust charter from the OCC that could subject the company to federal level regulation if fully approved.

**Policy Recommendations**
Many observers have acknowledged the gaps in the existing stablecoin regulatory frameworks and suggested policy alternatives. The PWG report and the Stablecoin Classification and Regulation Act of 2020 (STABLE Act; H.R. 8827 in 116th) recommended that Congress subject certain stablecoins to banking regulation. The Managed Stablecoins are Securities Act of 2019 (H.R. 5197 in 116th) suggested heightened regulation through securities laws. Policy alternatives for stablecoins include potentially regulating them as (1) MMFs, (2) MMFs plus heightened prudential measures such as capital and liquidity requirements, (3) special bank charters, (4) insured depository institutions, (5) FSOC-designated systemically important entities, and (6) under a separate new framework with one designated regulator for digital asset markets.

**CRS Resources**


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