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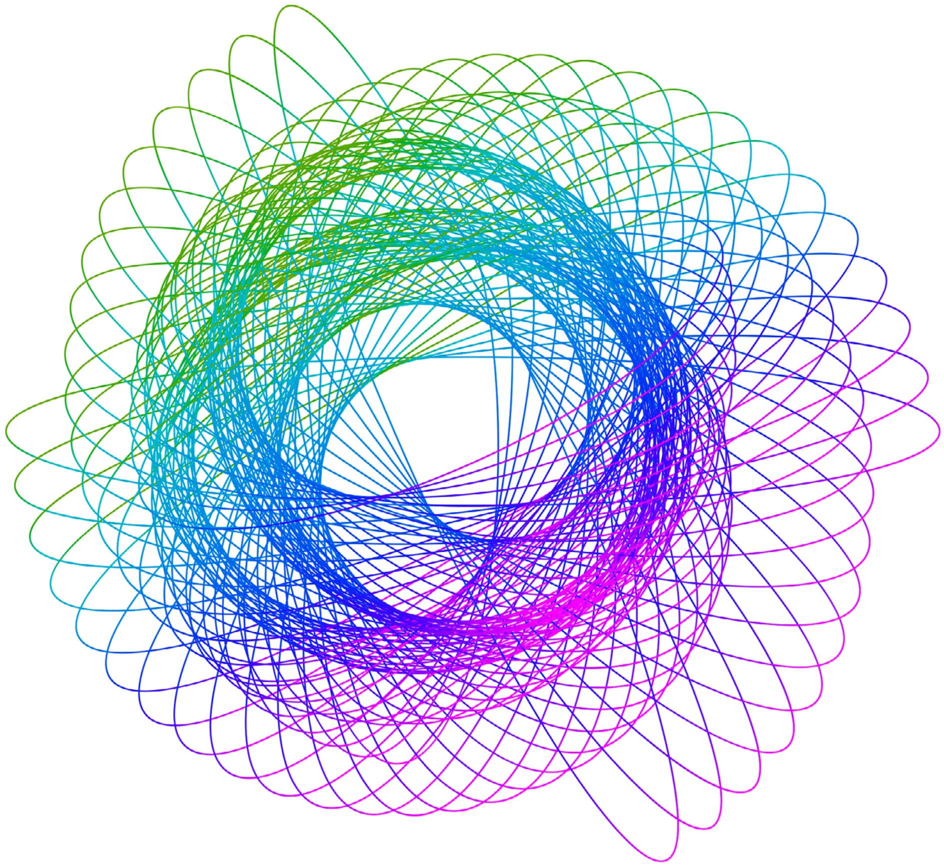


So, You Want to Be a Stablecoin Issuer?

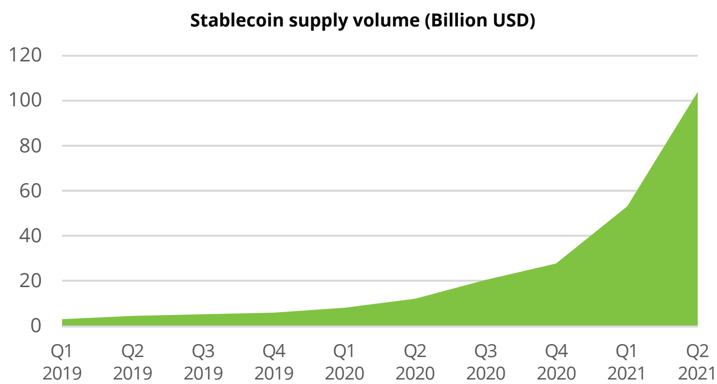
Continuing our *So, You Want to Be Bank?* series,[1] stablecoin issuance and adoption has captured US regulators' and the broader market's attention. Here, we will focus on fiat-backed stablecoins, whose value is typically pegged to the US dollar (or other currencies), using full collateralization by cash or publicly traded securities as a stabilization mechanism.

The trend in the digital assets market is highlighted in Deloitte's annual blockchain survey which collected views of 1,280 senior executives and practitioners from 10 countries in March and April 2021. The survey summarized views that 42% overall and 43% of Financial Services Industry (FSI) participants and 53% of FSI Pioneers believe that stablecoins or central bank digital currencies will have a positive impact on their organizations or projects.[2]

Stablecoin adoption is driven by traditional financial organizations' and the broader crypto industry's desire for a common way to leverage blockchain technology, while avoiding many of the related risks (e.g., volatility). Within that context, stablecoins have provided an on and off ramp option for digital assets.

The total market capitalization of all stablecoins has already exceeded $100 billion. Tether, USD Coin, and Binance USD are the three stablecoins with the highest market capitalization: $67.9 billion, $27.2 billion, and $12.2 billion respectively (as of August 24, 2021). Other major stablecoins include Dai, TerraUSD, TrueUSD, and Paxos Standard.[3]

Despite their growing popularity among financial market participants, stablecoins are exposed to significant regulatory risks and, hence, business risks. Regulators have voiced concern about the systemic threat stablecoins may pose to the stability of the financial system and have made it clear that stablecoins require scrutiny and a framework to set regulatory expectations.[4] Large stablecoin issuers—sensing potential regulatory impacts—are considering various paths to enter the US banking system.[5]



Whether you are a traditional bank, payment services provider, or stablecoin issuer—including their ecosystem participants—prudent preparation for a set of likely "bank regulatory" outcomes is imperative. Against this backdrop, this article lays out some key considerations to balance the underlying risks and potential opportunities in the respective strategies.

Stablecoin market opportunities & why many regulators are worried

Currently, a core driver of using stablecoins is real time payments over blockchain networks, enabling market participants to settle cryptocurrency transactions with "cryptodollars." Market participants may also use stablecoins to hold a fiat (value) equivalent without moving from digital assets back into fiat. Another key use case focuses on investment returns: Stablecoin holdings can be deposited to earn yields on decentralized finance (DeFi) markets. In simplified terms, investors may utilize DeFi directly, lending out their digital currencies to projects, borrowers, etc. in search of returns (e.g., "DeFi" lending), or use an intermediary (e.g., a crypto exchange firm) to invest the stablecoins on their behalf (e.g., Centralized Finance or "CeFi" lending).[6] In either case, the market yields on deposited funds can be significantly higher than bank interest rates.[7] Much of the regulatory framework around DeFi is still laregely undefined, creating risks and uncertainty for investors and market participants alike.

Capitalizing on the demand, the number of stablecoin issuers has been growing along with the market capitalization and trading volume of stablecoins.[8]

However, there is further market opportunity outside of "traditional" crypto realms. Combining the efficiency and speed of digital currencies with value stability, stablecoins often offer faster payments and more efficient money movement, potentially simplifying cross-border payments or potentially promoting financial inclusion. Stablecoins may be more effective for use as an everyday medium of exchange (i.e., money) than their highly fluctuating crypto counterparts. Eventually, stablecoins may attract a wider retail audience, spurring regulators' and policymakers' concerns.

Such concerns are primarily related to financial stability and consumer protection. The nature of stablecoins—functionally mimicking demand deposits, but without deposit insurance—makes them susceptible to runs when the reserves are not held in the safest forms, such as cash held in Federal Deposit Insurance Corporation (FDIC) -insured bank accounts and short-term US Treasuries, especially in times of market distress, posing systemic risk and potentially causing financial instability. Insufficient safeguarding against technical glitches is an additional source of concern, since most stablecoins do not offer insurance that adequately protects user funds. Mismanagement or abuse of reserves, technical issues with the stabilization mechanisms, or cyber incidents related to the underlying smart contracts may result in loss of value to consumers and other stablecoin users.

In addition, many US banking and securities regulators recognize that a shift to new forms of digital currencies will likely disrupt payment systems and credit creation. Through the disintermediation of deposits held at commercial banks, digital currencies have the potential to affect funding structures and liquidity portfolios, and—in turn—balance sheet size and composition.

The debate over stablecoin regulation has now become a strategic priority, as regulators have indicated that they are working through the potential implications and trade-offs. The Federal Reserve Chairman Jerome Powell warned that stablecoins are "*growing incredibly fast but without appropriate regulation*."[9] Additionally, the Securities and Exchange Commission (SEC) Chair Gary Gensler said cryptocurrencies whose prices depend on more traditional securities might fall under securities laws. "*Make no mistake: It doesn't matter whether it's a stock token, a stable value token backed by securities, or any other virtual product that provides synthetic exposure to underlying securities. These products are subject to the securities laws and must work within our securities regime. To the extent that there are securities on these trading platforms, under our laws they have to register with the Commission unless they meet an exemption*" he said.[10] The SEC may apply full investor protections of the Investment Company Act and other federal securities laws to these products. To mitigate risks posted by stablecoins, legislators and regulators may consider two trajectories for action:

(1) They could bring stablecoins into the banking regulatory perimeter and require deposits to be backed by FDIC insurance. There are several potential ways to achieve this, all of which would likely require current stablecoin issuers and players in their ecosystem to rethink their current business model:

- For instance, Congress could pass legislation that requires stablecoin issuers to become FDIC-insured banks.
- A compromise alternative would be to create a special type of license that applies to stablecoin issuers and requires them to meet bank-like capital, liquidity, and deposit insurance requirements.
- In another, more indirect approach, the federal banking agencies or the Congress could classify stablecoin holdings as demand

deposits, thereby requiring issuers to have a banking license. From a functional and economic perspective, this might make sense, given that most stablecoin deposits (albeit not all, for example, Tether would be an exception) are essentially based on debt contracts, conveying the right to redeem the token for cash on demand. The potential ramifications may, however, go beyond stablecoins: Non-bank payment providers could also find their products within the scope of the demand deposit definition.
- Yet another option would be for the Financial Stability Oversight Council (FSOC) to designate stablecoin issuance as a systemic payment activity. In response to such designation, the Federal Reserve Board (FRB or Fed) may require that stablecoins only be issued from FDIC-insured banks.

(2) As an alternative to pulling stablecoins into the perimeter of banking regulation, governments may consider accelerating the development of central bank digital currency (CBDC),[11] potentially taxing/regulating certain forms of private stablecoin issuers out of existence where they perceive unacceptable risks.

The recent discussion among Federal Reserve officials centers on whether to introduce a CBDC or to instead leave digital payments innovation to the private sector and simply ensure that private stablecoins are well regulated. According to the Federal Reserve Chair Jerome Powell, if the Fed were to move forward with developing a CBDC, then "You wouldn't need stablecoins; you wouldn't need cryptocurrencies, if you had a digital US currency."[12] It would represent a direct claim against the central bank.

Current state of regulatory affairs

As US regulators have yet to agree on a federal approach, the lack of consensus has resulted in a patchwork of guidance at a state and federal level. In an attempt to keep pace with crypto innovation some states have issued guidance stating that virtual currencies are subject to money transmission laws, and others have amended their existing money transmission laws to include virtual currencies. Yet others are undecided in their approaches.

The New York State Department of Financial Services (NYDFS) has demonstrated regulatory leadership by issuing its virtual currency regulation, 23 NYCRR Part 200 (BitLicense regulation), for businesses operating in the virtual currency industry.[13] Virtual currency businesses in New York can either apply for a BitLicense or for a charter under the New York Banking Law (such as a New York State limited purpose trust company) to operate as a limited liability trust company. A trust charter provides additional benefits, such as fiduciary powers and money transmission powers (without the need for a separate money transmitter license), but has stricter regulatory requirements with the necessity to apply to the New York Banking Board, rather than just the NYDFS. The NYDFS expects BitLicense applicants to demonstrate capabilities to support a cybersecurity program, consumer protection through policies and disclosures, an asset safeguarding framework, and anti-money laundering/sanctions (AML) programs. To bypass the rigorous BitLicense application process and to promote efficient business expansion, the NYDFS has also proposed a conditional BitLicense that can be awarded outside of the regular application process. Under its terms, the new entrant works in collaboration with an authorized virtual currency business (BitLicensee or holder of a New York limited purpose trust charter). The framework describes general process steps, including (1) notice to the NYDFS of the intent to work with an authorized virtual currency business; (2) submission of necessary business information; (3) application review; (4) contract development between the NYDFS and the applicant; (5) final approval.

At the federal level, authorities and policymakers have recently announced plans in various shapes to address stablecoins (in order of issuance date provided below):

- On July 28, 2021, Rep. Don Beyer (D-VA) introduced the Digital Asset Market Structure and Investor Protection Act,[14] which would incorporate digital assets, including stablecoins, into existing financial regulatory structures. If enacted, the Secretary of the Treasury would establish an application process for fiat-based stablecoin issuers and—while considering the application—would consult with the FRB, SEC, Commodity Futures Trading Commission (CFTC), and other agencies as appropriate. No person would be able to issue or use a fiat-based stablecoin that was not approved by the Secretary of the Treasury and no grandfathering of existing stablecoins would be allowed.
- On July 20, 2021, the President's Working Group for Financial Markets had the first publicly announced meeting since President Biden took office to discuss stablecoins. They have announced that recommendations for stablecoin regulation will be published within the next few months.[15]

"The Federal Reserve has traditionally supported responsible private-sector innovation. Consistent with this tradition, I believe that we must take strong account of the potential benefits of stablecoins, including the possibility that a US dollar stablecoin might support the role of the dollar in the global economy."

- On June 28, 2021, the Federal Reserve Vice Chair Randal Quarles said at a bankers conference in Utah that the US should find ways to say "yes" to stablecoins. He stated *"The Federal Reserve has traditionally supported responsible private-sector innovation. Consistent with this tradition, I believe that we must take strong account of the potential benefits of stablecoins, including the possibility that a US dollar stablecoin might support the role of the dollar in the global economy."*[16]
- In January 2021, the Office of the Comptroller of the Currency (OCC) released a letter saying that banks may use stablecoins to carry out permissible payment activities in accordance with applicable regulations. The OCC considers stablecoins as a mechanism of payment, similar to debit cards, checks, and electronically stored value (ESV) systems that convey payment instructions.
- In December 2020, members of the Congress bought forward a proposal to increase the oversight of stablecoins, the Stablecoin Tethering and Bank Licensing Enforcement (STABLE) Act. It effectively seeks to convert stablecoin issuers into depository institutions which are insured by the FDIC. Such an action would likely bring other banking regulations in scope.[17]
- The OCC released a letter in September 2020 stating that national banks are allowed to hold reserves for stablecoins backed by fiat currency on at least a 1:1 basis on behalf of customers who issue stablecoins. However, the bank should verify at least on a daily basis that reserve account balances are always equal to or greater than the number of the issuer's outstanding stablecoins.
- The Director of the US Financial Crimes Enforcement Network (FinCEN) has said that stablecoins are covered by the FinCEN's definition of "money transmission services" and a company accepting and transmitting activity denominated in stablecoins is considered a money transmitter under the Bank Secrecy Act (BSA) for the purposes of AML/CFT (Anti-Money Laundering/Combating the Financing of Terrorism).[18]

In the meantime, regulatory pressure could also be exerted by consumer protection efforts. While the Consumer Financial Protection Bureau (CFPB) has not yet initiated any rulemakings or enforcement actions with respect to virtual currencies, continued increases in consumer complaints filed with the CFPB could result in new scrutiny.[19] The CFPB has broad authority under Title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act to potentially issue enforcement actions to virtual currency companies or exchanges for "unfair, deceptive, or abusive acts and practices." In this regard, Senator Elizabeth Warren, the architect of the CFPB, has recently urged it to take a closer look at virtual currency.[20] The consideration for market participants is to focus on building comprehensive and effective compliance management systems (CMS), which include an internal consumer complaints response program to provide a voice to the consumer for raising concerns and seeking redress where appropriate.

Whatever the future of money looks like, with stablecoins having risen to the top of their agendas, policymakers will likely attempt to keep pace with innovation and ensure that they can maintain confidence in the stability of the financial system. Further, they may want to consider some of the commercial advantages of "programmable money" along with the ability to program in compliance. While regulation may eventually manifest in different ways, stablecoin issuers and their ecosystem players should, at the very least, expect minimum standards on different capabilities and domains, including capital, liquidity, treasury, compliance, finance, and deposit insurance. They will need to demonstrate sound governance, legal certainty, and operational resilience in an abundantly transparent way, consistent with the public interest in stable and well-functioning financial markets.

Impacts and Competitive Challenges

Next, we look at the impacts and competitive challenges separately through the lens of each of the current stablecoin stakeholders, namely commercial banks, payment processors, and stablecoin issuers.

A. Banks

Traditional banks should look at the stablecoin roadmap from two perspectives: First, from a macro risk management angle, some stablecoins may pose disruption or volatility risks in financial markets given their sizeable participation in, for instance, commercial paper markets. Some issuers have their stablecoins backed by dollar-denominated reserve assets held in securities products like commercial paper, and mass redemption of those stablecoins in times of stress may impact stability of short-term credit markets. Disorderly withdrawals from stablecoins have the potential to create or exacerbate liquidity stresses which could be incorporated into banks' existing models.[21] Banks that participate as players in the stablecoins ecosystems will likely be impacted more directly (e.g., depository banks might face reserve drawdowns in times of stress).

Second, from a competitive angle, the wider adoption of stablecoins may affect the funding models, product pricing, the strategic positioning of banks, and the nature of customer relationships, including access to data on customer financial behavior. The specific characteristics of banks' businesses, including their existing funding structures, the make-up of their deposit base, and the propensity of different segments of their customer base to adopt new technologies, will determine the scale of the competitive threat. Banks' capacity to reprice deposits will also vary. On the flipside, digital currencies will likely create new competitive opportunities for bank to innovate and to position themselves to succeed in the digital financial landscape. Even in the CBDC scenarios there will likely remain a significant role for the private sector to act as intermediaries and providers of add-on services linked to their core banking propositions. Banks may take the view that by facilitating the use of digital currencies, for instance by offering "wallet" functionalities alongside conventional accounts, they could retain better line of sight over digital currency customer behavior, instead of letting payment transactions and deposits bypass their rails. Adoption of stablecoins could also help them increase the velocity of transaction flows by deploying stablecoins as programmable money among their own smart contracts that govern their own financial products. Banks may be better positioned to adapt their businesses to thrive in the new environment by engaging early.

In the near-term, banks should work through the range of possible scenarios in which stablecoins could unfold, engaging strategy, regulatory policy, product innovation and technology teams. There are a number of items to be explored as part of the possible response set, including risk and compliance framework enhancements, product pricing, controls implementations, balance sheet adjustments, and others. To facilitate the preparation process, we have identified some core functions that should be analyzed to determine the level of impact while developing near-term response strategies.

It is worth noting that banks are likely to benefit from tighter regulation across most scenarios, including through the potential mitigation of financial, strategic, and competitive risks that greater regulation may present.

B. Money Transmitters and Payment Service Providers

Payment services providers that transact in stablecoins should prepare for potentially heightened regulatory scrutiny with an evolving regulatory landscape. This is particularly relevant for firms that partner with stablecoin issuers or participate in the stablecoin value chain. Federal expectations will eventually become clearer and state money transmitter licensing (MTL) regimes may further evolve clarifying the coverage of virtual currencies. A significant focus will likely remain on AML expectations, with further clarity forthcoming from the FinCEN.

Against this backdrop, payment services providers should acknowledge the risk associated with deep stablecoins integration and dependency. They may want to consider avoiding long-term commitment and adopt contingency plans to mitigate negative reputational and business impacts if certain stablecoins, or the stablecoin business in general, become unviable as a result of upcoming regulation. However, regulatory changes, such as an updated definition of demand deposits, could also affect payment services providers that are not currently active in the stablecoin business.

Like banks, some payment processors may also face competitive threats from stablecoins, especially if they haven't yet managed to claim their spot in the value and supply chain of stablecoins.

C. Stablecoin issuers

Stablecoin issuers themselves will primarily navigate through a period of regulatory transition, which could take a variety of forms, as outlined above. Across all feasible scenarios, issuers can expect a bank-like outcome and should be prepared to adhere to heightened prudential requirements. At the extreme end of the scenario spectrum, issuers may need to drastically pivot their existing business model in order to survive, be it due to public competition in the form of CBDCs or because they become subject to the full suite of banking regulation. In the meantime, to address some of the regulatory focus areas proactively, stablecoin issuers have already started to shift to more cash in their asset reserves.

Impact and response framework

To help prepare for the future, we have developed an "impact and response framework" that highlights capability areas for Banks, Stablecoin Issuers, and Payment Processors and lays out some considerations for enablement of digital currency solutions. While recognizing a wide spectrum of risks, our framework is anchored in existing and likely future high-level regulatory expectations.

A challenge for a universal approach is that stablecoin arrangements are not all equal, and the opportunities and risks they present depend on the structure and design underlying each stablecoin. There are commonalities, however. Some of the risks—for example, regarding the safety and efficiency of payment systems, money laundering and terrorist financing, consumer/investor protection, and data protection—are familiar and could be addressed, at least partially, within existing regulatory, supervisory, and oversight frameworks. However, their implementation and enforcement may involve additional complexity given the nature of certain stablecoins. Stablecoin issuers, including their ecosystem players, will likely be expected to meet the same criteria and abide by the same regulatory requirements as traditional payment systems, payment schemes or providers of payment services in order to ensure they are appropriately designed and operate safely and effectively in accordance with public policy objectives. All of the below impacts are potential considerations and are subject to additional regulatory clarity.

Potential Regulatory Expectations	Applicability to Participants			Considerations (Based on Industry Experience)
	Stablecoin Issuers	Commercial Banks	Payment Processors (incl. Money Transmitters)	
Business Strategy				
• Analysis of a range of impact scenarios covering the regulatory, risk, and competitive landscapes • Articulating business strategies, supported by scenario-based pro-forma projections, and creation and maintenance of a business plan	High	Medium	High	• Issuers should anticipate regulatory scrutiny and potential competition from CBDCs by adopting credible risk/control frameworks and conducting fundamental business viability analyses • Banks should define how they want to engage with stablecoins, and what specific steps they will take given existing capabilities; in addition, banks should identify "at risk" business lines (e.g., where margin pressures will be acute) and develop a response framework across affected functions such as risk management, funding, product innovation, and integration with existing digitization and technology strategies • Payment processors will have similar impacts like banks, but the competitive pressure and strategic significance will likely be more accentuated; additionally, contingency plans can help mitigate negative reputational and business impacts if certain stablecoin business models become unviable/unsustainable
Enterprise Risk Management (ERM)				
• Formalized enterprise management capabilities, including ability to identify risks, measure, monitor and report • Articulation of risk appetite and linkage to strategy • Controls mapped to identified risks • Enterprise risk reporting	High	Low	Low	• Stablecoin issuers have not had to face formal bank-like risk management expectations, therefore regulatory expectations will drive impact (e.g., risk and control self-assessment process) • Banks and payment processors would likely need to enhance their ERM frameworks (along with articulating an updated risk appetite statement) and account for the unique risks posed by stablecoins
New Product Approval (NPA) • Robust risk management of modifications made to products – full risk assessment and approval of products • Established NPA process to ensure that risk—including reputational risk, conduct risk, and franchise risks—associated with a new product/service are identified and managed accordingly	High	Medium	No	• Stablecoin issuers would likely need to stand up a formal new product approval and governance process • Banks should prepare for modifications to the NPA process to ensure that unique risks are accounted for

High impact   Medium impact   Low impact   No impact

6

Potential Regulatory Expectations	Applicability to Participants			Considerations (Based on Industry Experience)
	Stablecoin Issuers	Commercial Banks	Payment Processors (incl. Money Transmitters)	
Compliance				
Compliance framework updates to effectively manage specific compliance obligations posed by stablecoins, including privacy, consumer protection, and other key impacts posed by stablecoins				• Stablecoin issuers should develop the policy, procedures, and compliance programs akin to banks • All market participants may be impacted by consumer protection and compliance requirements • Banks may need to update their compliance framework for stablecoins, potentially requiring major changes given the regulatory uncertainty and new risks which come into scope • Compared to banks, payment processors may be subject to less stringent regulatory requirements because they do not carry stablecoins on the balance sheet; however, they should be cognizant of any amendments to state specific MTLs • All market participants should also establish a consumer complaints response process to effectively respond to consumer concerns as well as to identify emerging operational problems before they result in larger compliance or reputational risk issues
BSA/AML program • Know your customer: Customer identification program, customer due diligence, enhanced due diligence • Office of Foreign Assets Control (OFAC) and sanctions • Transaction monitoring, including SAR reporting • Record keeping				• Both issuers and payment processors need to establish BSA/AML and sanctions programs with the necessary controls that are consistent with the risks posed by products, services, and customer base; regulators expect that these BSA/AML/sanctions programs are reasonably designed to assure and monitor compliance with applicable laws and regulations, including the suspicious activity reporting requirements • If stablecoins are a new product offering, institutions may need to update their existing BSA/AML/sanctions programs • This area will likely remain a significant focus area for regulators in ensuring bad actors are not using blockchain rails or stablecoins to commit fraud or move illicit money

High impact   Medium impact   Low impact   No impact

Potential Regulatory Expectations	Applicability to Participants			Considerations (Based on Industry Experience)
	Stablecoin Issuers	Commercial Banks	Payment Processors (incl. Money Transmitters)	
Governance				
• Defined organizational structure having clear business line and legal entity structure; key interrelations and dependencies between institution subsidiaries and nonbank affiliates • Strong governance arrangements with effective oversight and internal controls • Effective board and management committees • Defined roles and responsibilities for the board, management committees, second line committees and business to ensure risk-taking activities are in line with the organization's strategic objectives and risk appetite				• A strong corporate governance framework can help issuers and payment processors manage the risks better and demonstrate efficient oversight • Adoption of a three lines model will have significant operational impacts on stablecoin issuers • Strong governance and oversight for issuer firms can help reduce the risk of fraud or abuse of reserves • Banks should consider whether any updates to their corporate governance (including committees and cross-functional internal advisory bodies) may be needed when including stablecoins in their portfolio; demonstrating effective challenge of new business and ongoing monitoring of crypto risks will be key
Third Party Risk and Intercompany Governance				
• Established third party risk management program meeting banking regulatory expectations, including inventory, risk rating, due diligence, and ongoing performance monitoring • Where Issuers leverage other affiliate services, they will need to consider service level agreements to document performance expectations and controls for oversight and monitoring				• Issuers should establish a third-party risk management framework including due diligence during selection, maintain written contracts specifying clear roles and responsibilities, monitor third parties on an ongoing basis, and execute contingency plans in case of terminations. This should also extend to performance monitoring • Banks should update the existing third-party risk management processes as they are onboarding new types of vendors to enable settlement • Payment processors may need to contract with third parties to perform functions which have been in-house previously • Issuers and payment processors should establish intercompany governance processes and related controls to manage affiliate relationships.

High impact   Medium impact   Low impact   No impact

Potential Regulatory Expectations	Applicability to Participants			Considerations (Based on Industry Experience)
	Stablecoin Issuers	Commercial Banks	Payment Processors (incl. Money Transmitters)	
Treasury				
• Capital adequacy and capital management processes demonstrating ability to withstand significant stress • Liquidity management, including measurement of liquidity and contingency planning • Balance sheet management • Contingency planning				As regulatory requirements become clearer, considerations include: • Banks and Issuers should analyze how stablecoins may impact their capital and liquidity requirements including forthcoming guidance on capital and liquidity treatment • Issuers should develop capital and liquidity policies and develop forecasting capabilities to ensure adequacy. This will extend to stress testing and sensitivity analysis which could result in contingency capital and funding plans. • Regulators will likely further expect significant contingency planning
Technology & Information Security				
Information security & BCP • Disaster recovery and business continuity planning • Information security program supporting IT controls and risk management process • Cybersecurity framework to ensure delivery of critical services and manage issues relating to cyber and data security incidents				• Issuers should set up an information security program and a business continuity plan to deal with information security issues and extreme events • Banks participating in the stablecoin ecosystem should update their information security and business continuity plan to include stablecoin-related specifics • Payment processors using stablecoins may be at risk in the case of adverse events and should take steps to plan for such situations
Technology architecture • Technology architecture enhancement and controls implementation supporting digital currency authorization and settlement				• Issuers and payment processors will likely need to design a technology architecture to facilitate digital currency transactions • Payment processes may face integration challenges with existing fiat currency models and services • Banks can facilitate the use of digital currencies, for instance, by offering "wallet" functionalities alongside conventional accounts

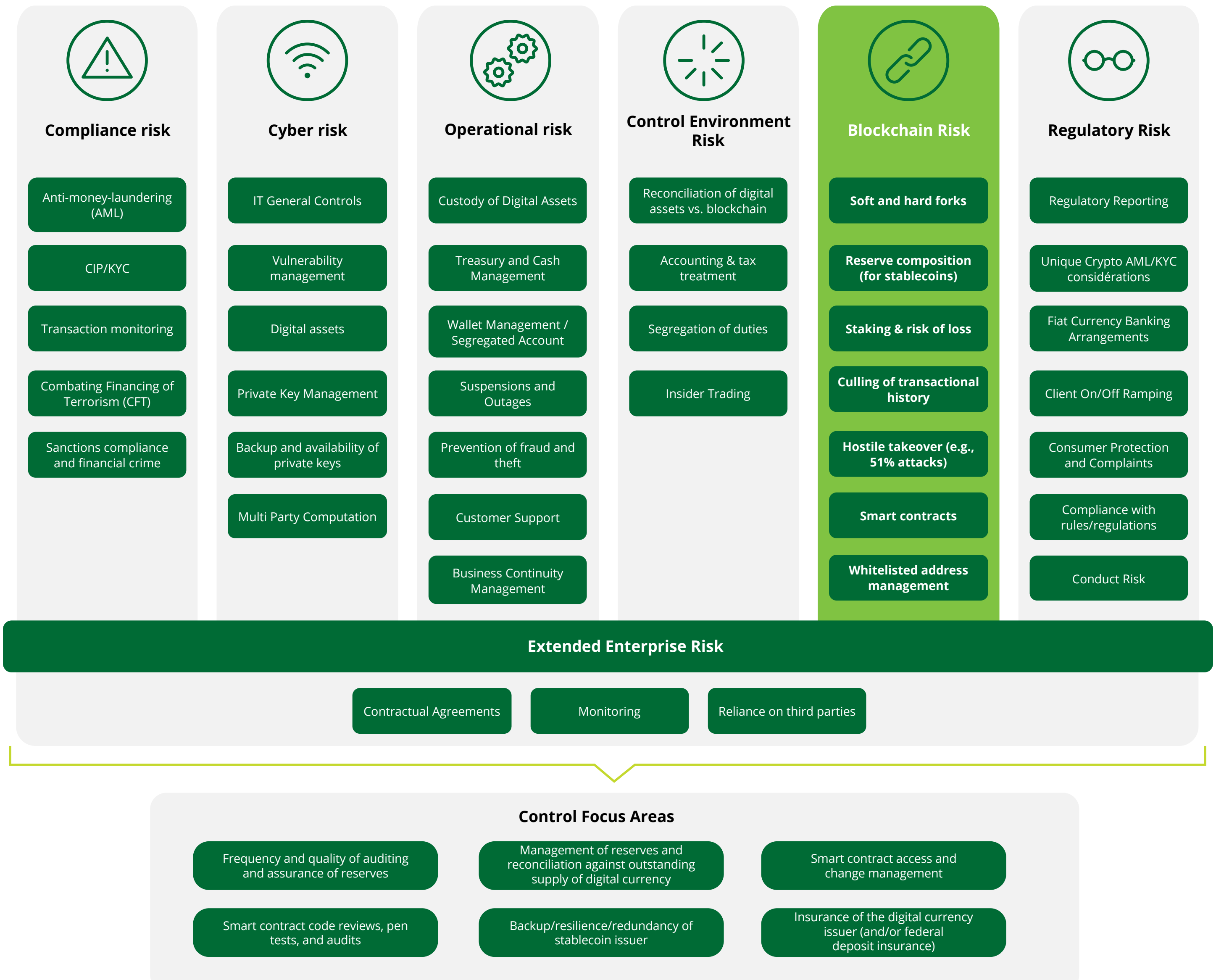
High impact Medium impact Low impact No impact

Potential Regulatory Expectations	Applicability to Participants			Considerations (Based on Industry Experience)
	Stablecoin Issuers	Commercial Banks	Payment Processors (incl. Money Transmitters)	
Reporting & internal controls				
• Regulatory reporting • Financial reporting • Tax Informational Reporting • Accounting and internal controls • Transparency provided by external audits • Income tax treatment				• Even though currently there is limited reporting mandated for issuers, they should plan for setting up likely regulatory reporting requirements and this may include setting up the internal control and quality assurance frameworks to ensure complete, timely and accurate reporting • Banks should update the reporting mechanisms (financial, tax and regulatory) to include stablecoins in alignment with regulatory expectations, update their existing internal controls and create additional controls (if required) to manage risks due to stablecoins • Payment processors using stablecoins may be expected to produce additional regulatory and financial reports and update existing or create new internal controls to deal with risks arising from stablecoins • All stakeholders should undergo a thorough analysis of the income tax treatment of the stablecoin from the perspective of the issuer and the holder; without specific tax guidance on stablecoins, this may require consideration to the terms, conditions, and operational design • Providing transparency on reserve makeup and internal controls is rapidly becoming an accepted leading practice from stablecoin issuers and is a likely requirement to be included in future regulation

High impact Medium impact Low impact No impact

Getting Started

A broad-based identification of the unique risks posed by stablecoins and blockchain technology—and the associated controls—will underpin the above impacts. If you are an issuer or a bank engaging in stablecoins this may be a good way to get started. Regulators will expect stablecoin participants to implement and maintain robust risk management and governance processes and procedures for the maintenance of their risk profiles and control environment. The risk framework below is reflective of the lessons we have learned over time serving digital assets clients. While not entirely exhaustive across the full range of business models and market participant types, it provides a useful starting point as part of a risk assessment exercise to create an effective governance and risk management framework.



In the near-term, banks, payment processors, and stablecoin issuers should work through the range of possible scenarios to analyze how the above-described impacts may specifically unfold and develop response strategies. Also, with the rapid pace of innovation, opportunity may exist for stablecoin ecosystem players amidst the uncertainty. They should build out an implementation framework to strategically position themselves in this digital financial landscape and obtain competitive advantage. To this end, participants should develop a deep understanding of risks and prepare to respond to a likely high bar.

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7 A lack of regulation also means that investors may be exposed to risks of bugs in smart contract code or other exploits that are unique to DeFi.

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