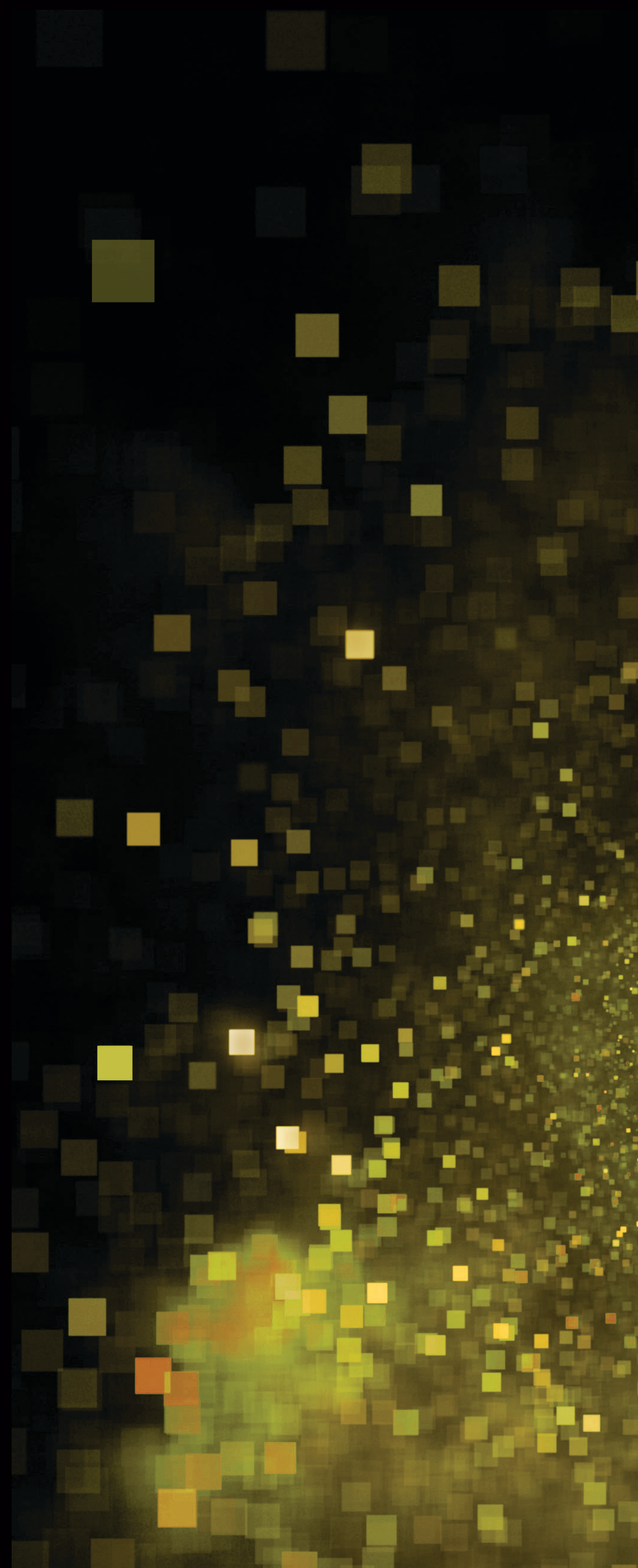
Stablecoin regulatory update and enhanced framework

February 2022

On September 9, 2021, Deloitte published "So, You Want to Be a Stablecoin Issuer?," which provided an overview of the dynamic market and regulatory landscape at that time. In addition, we outlined governance, risk, and control considerations for market participants—including digital native firms—interested in issuing stablecoins or providing services within the stablecoin ecosystem.[1] To help them navigate the process, we outlined an "impact and response framework" that was anchored to industry-leading practices and existing regulatory guidance.

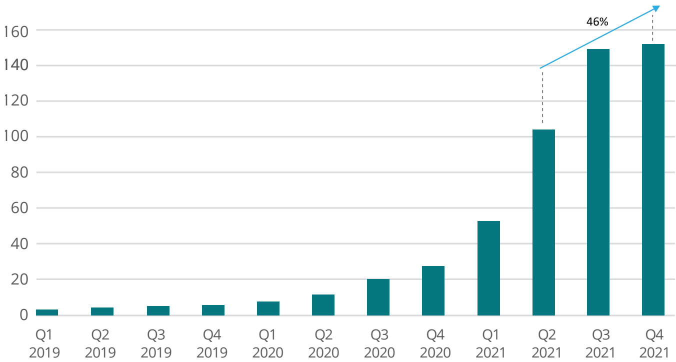
Whether you are a traditional bank, payment services provider, or stablecoin issuer—including their ecosystem participants—prudent preparation for a set of bank-like regulatory outcomes is imperative. This update to the September 2021 report refreshes the impact and response framework based on recent regulatory releases.



What's changed

Stablecoin adoption by traditional financial organizations and the broader crypto industry is growing rapidly as a common way to leverage blockchain technology while avoiding many of the related risks (e.g., volatility). This is evident by the increased market capitalization for dollar-denominated stablecoins, which has risen from $100 billion to more than $152 billion (as of December 31, 2021) since our original report in September.

Stablecoin supply volume (Billion USD)



Meanwhile, the pace of regulatory and congressional focus continues to intensify. Because many of the largest stablecoins are pegged to the US dollar, regulators are especially concerned about potential spillover effects to the broader financial system: 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. This is especially true in times of market distress, posing potential systemic risk and amplifying adverse effects on financial stability. Further, if the market value of stablecoins grows sufficiently large, the collapse of a major stablecoin could have ramifications for the US Treasury market, creating concerns about contagion. Insufficient safeguarding against technical glitches and consumer protection are of additional concern, since most stablecoins do not offer insurance that adequately protects user funds.

Recent regulatory updates

Federal US authorities and policymakers as well as international standard setters have recently announced plans in various shapes to address stablecoins (in order of issuance date provided below):

- On January 18, 2022, Agustín Carstens, General Manager of the Bank for International Settlements (BIS), delivered a speech titled "Digital currencies and the soul of money." He expressed concern that when stablecoins are issued by big tech companies, they could potentially erect barriers against new entrants, reduce competition, fragment monetary systems, and undermine financial stability in the absence of appropriate regulations. In addition, vast amounts of financial data collected by stablecoin issuers may pose privacy risks. Carstens also stated that over-reliance on private money could lead to a monetary system built upon firms' profit considerations rather than the public interest, and that a lack of oversight could erode public trust.[2]
- On January 13, 2022, Acting Comptroller of the Currency, Michael J. Hsu, spoke before the British American Business Transatlantic Finance Forum's Executive Roundtable to discuss the regulation of stablecoins and other crypto-assets. Hsu stated that stablecoins are "the oxygen of the crypto ecosystem," as they help link cryptocurrencies to fiat currencies. He also argued that regulation would help mitigate stablecoin-related run risks, strengthening confidence among holders that their coins are as reliable as bank deposits. Hsu advocated for regulating stablecoin issuers as banks to increase the durability of innovations in stablecoins. He noted that strong federal regulations would help lay a solid foundation for the economy, allowing for healthy economic growth.[3]
- On December 17, 2021, the Financial Stability Oversight Committee (FSOC) expressed its commitment to consider steps available to address risks related to stablecoin, should Congress fail to take comprehensive legislative action.Within its remit, the FSOC could, for example, designate certain stablecoin-related activities as systemically important payment, clearing, and settlement (PCS) activities. Such designation would permit the appropriate agencies to establish risk management standards for financial institutions (including nonbank financial institutions) that engage in designated PCS activities (e.g., in relation to reserve asset backing, compliance with prudential standards).[4]
- On December 14, 2021, the US Senate Committee on Banking, Housing, and Urban Affairs discussed the future of stablecoin regulation. The committee recognized that, while stablecoins have benefits related to cross-border transfers and cost reduction, they also carry significant risks due to limited disclosure and are operating without clear regulatory standards. Sen. Patrick J. Toomey (R, PA) recommended that stablecoin issuers should be given three options under which to operate: a traditional bank charter, a special purpose banking charter designed for stablecoin issuers, or registration as a money transmitter.[5]
- On November 23, 2021, the Office of the Comptroller of Currency (OCC) issued a letter clarifying that crypto custody services (i.e., holding reserve assets for deposits and stablecoin activities to facilitate payment transactions on a distributed ledger) are legally permissible for a national bank provided the national bank can demonstrate, to the satisfaction of its OCC supervisory office, that it has controls in place to conduct the activity in a safe and sound manner. National banks must seek written OCC supervisory non-objection before engaging in crypto activities in the future.[6]
- On November 1, 2021, the President's Working Group (PWG) on Financial Markets, the FDIC, and the OCC released a report acknowledging the presence of fundamental gaps in prudential authority over stablecoins used for payment purposes. The report analyzes these gaps and recommends federal legislative action aimed at creating a federally harmonized oversight framework for stablecoins as well as interim action by regulators to leverage existing rules within their current jurisdictions.[7]
- On October 28, 2021, the Financial Action Task Force (FATF) released updated guidance for a risk-based approach for virtual assets and virtual asset service providers. With a focus on stablecoins, the guidance clarifies the definitions of virtual assets (VAs) and virtual asset service providers (VASPs), explains how FATF standards apply to stablecoins, updates guidance on addressing

risks and tools for addressing money laundering, and updates licensing and registration guidance among others.[8] US regulators and supervisors will likely reflect the new guidance in federal requirements and prudential supervision.

- On October 6, 2021, the Committee on Payments and Market Infrastructures (CPMI) along with the Board of the International Organization of Securities Commissions (IOSCO) released a consultative report on the *Application of the principles for financial market infrastructures to stablecoin arrangement*s. The report defines key terminology and concepts regarding stablecoin arrangements (SAs) and the systemic importance of SAs, along with guidance on the application of the four key principles, namely Governance, Risk Management, Settlement Finality, and Money Settlements for systemically important SAs.[9] While not immediately relevant for stablecoin-related activities in the United States, the CPMI/IOSCO paper may shape forthcoming US regulation and supervision by providing a standardized nomenclature and conceptual regulatory blueprint.

Impacts and competitive challenges

To analyze the broad range of regulatory impacts and competitive challenges associated with stablecoins, we take the perspective of different market participants, namely commercial banks, payment processors, and (potential) stablecoin issuers.

Banks

Traditional banks should look at the stablecoin road map from two perspectives: First, from a macro risk management angle, some stablecoins may pose disruption or volatility risks in financial markets given their sizable participation in, for instance, commercial paper markets. Disorderly withdrawals from stablecoins have the potential to create or exacerbate liquidity stresses, which could be incorporated into banks' existing models.[10]

Second, from a competitive angle, the wider adoption of stablecoins may affect the funding models and product pricing of banks through deposit disintermediation. Currently low-cost and stable retail deposits could flow from traditional bank deposits into stablecoins (issued by nonbank financial system participants or, if legally required, by depository banks). Even if these funds arising from stablecoin issuance end up on banks' balance sheets (either as a means to back a particular stablecoin or because the issuer is required to be a bank, as suggested by the PWG report), they are likely a less effective source of funding for liquidity management and modeling purposes. In turn, this dynamic could lead to increases in the cost of bank credit, if some banks are forced to replace cheaper funding with more expensive sources. Some banks also could decide to reduce lending.

These changes may create opportunities for nonbanks to take a greater role in credit provisioning as relative funding costs are altered.[11] In parallel, stablecoin growth could further popularize decentralized finance (DeFi) lending and amplify the competitive pressure for banks in the loan business. Deposit disintermediation also could drive the further commoditization of traditional commercial banks through the loss of customer relationships, limiting opportunities for cross-selling of banking services. Fee income may shrink, too, if transactions increasingly migrate from current payment rails to digital ones.

On the flipside, stablecoins will likely create new competitive opportunities for banks to innovate and to position themselves to succeed in the digital financial landscape, and banks may be better positioned to adapt their businesses to thrive in the new environment by engaging early.

In the near term, banks should continue to work through a range of scenarios, including potentially using stablecoins to enable payments and banking activities as well preparing for market participants that use stablecoins. This will require cross-functional teams including Legal, Compliance, Risk, Technology, and the business to work collaboratively through impacts, strategy, and overall business plans.

Money transmitters and payment service providers

Payment service providers that transact in stablecoins should prepare for potentially heightened regulatory scrutiny within the evolving regulatory landscape. This is particularly relevant for firms that partner with stablecoin issuers or participate in the stablecoin value chain. For instance, the PWG report recommends that prudential standards be applied to all activities critical to the functioning of a stablecoin arrangement. As a result, many ecosystem players, such as money transmitters and payment service providers, may find themselves being pulled into a regulatory environment that poses additional and significant requirements and challenges, and that conceivably could include bank-like activity restrictions that limit affiliation with commercial entities. In addition, the PWG report suggests that supervisors should have the power to facilitate interoperability among stablecoins and across other means of payment.

Against this backdrop, payment service providers may want to consider avoiding long-term commitments and adopt contingency plans to mitigate negative business impacts if certain stablecoins, or the stablecoin business in general, become unviable as a result of upcoming regulation.

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 likely scenarios, existing issuers may expect a bank-like outcome and should be prepared to adhere to heightened prudential requirements. The PWG report has already recommended that stablecoin issuers be required to become FDIC-insured depository institutions, and that only FDIC-insured depositary institutions be able to mint stablecoins. If enacted, stablecoin issuers would need to obtain a federal or state banking charter and would be subject to bank-like regulations (e.g., related to risk management, capital and liquidity requirements, and resolution regimes).

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 to taking a universal approach is that stablecoin arrangements are not equal, and the opportunities and risks that 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. The specific characteristics of a given stablecoin will drive the relative complexity involved in the application of the regulatory frameworks.

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 impacts described below are potential considerations and are subject to additional regulatory clarity.

Potential Regulatory Expectations	Applicability to Participants			Considerations (Based on Industry Experience)
	Stablecoin Issuers	FDIC-Insured Depository Institutions	Payment Processors	
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 impact	Medium impact	High impact	• Issuers might consider obtaining a bank charter or partnering with existing banks in view of the recommendation from PWG, OCC, and FDIC to limit stablecoin issuance to FDIC-insured depository institutions • In anticipation of tighter regulatory scrutiny and potential competition from central bank digital currencies (CBDCs), issuers should also adopt credible risk/control frameworks and conduct 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 or unsustainable • Any firm, including payment processors or other nonbanks, engaging in stablecoin-related activities and/or providing critical services to stablecoin arrangements, such as storage, custody, redemption, or maintenance of reserve assets, might consider stepping up its risk management capabilities in anticipation of enhanced prudential standards, as suggested by the recent PWG report

High impact | Medium impact | Low impact | No impact

Potential Regulatory Expectations	Applicability to Participants			Considerations (Based on Industry Experience)
	Stablecoin Issuers	FDIC-Insured Depository Institutions	Payment Processors	
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 impact	Low impact	Low impact	• With stablecoin issuance possibly limited to insured depository institutions, there would be enhanced supervision and prudential regulation which in turn would require stablecoin issuers to adopt sound ERM frameworks • With banks increasingly required to receive written notification of supervisory non-objection to carry out stablecoin-related activities, it is imperative to have an appropriate risk management and measurement process for the activities, including having adequate systems in place to identify, measure, monitor, and control risks of their activities, including the ability to do so on a daily basis • A possible FSOC designation of stablecoin arrangements as, or as likely to become, systemically important payment, clearing, and settlement (PCS) activities would require the involved companies to meet additional requirements related to risk management, in relation to the assets backing the stablecoin, the operation of the stablecoin arrangement, and other prudential standards • Banks and payment processors would need to enhance their ERM frameworks (along with articulating an updated risk appetite statement) and account for the unique risks posed by stablecoins • All stablecoin ecosystem participants should demonstrate the capability to regularly review the material risks arising from stablecoin arrangements and identify and implement appropriate mitigants, taking an integrated and comprehensive view of their risks

High impact　Medium impact　Low impact　No impact

Potential Regulatory Expectations	Applicability to Participants			Considerations (Based on Industry Experience)
	Stablecoin Issuers	FDIC-Insured Depository Institutions	Payment Processors	
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 impact	Medium impact	No impact	• Stablecoin issuers would need to stand up a formal new product approval and governance process in line with the process followed by insured depository institutions • Banks should prepare for modifications to the NPA process to ensure that unique risks are accounted for
Regulatory relations				
• Regulatory communications • Regulatory and legal interpretation	High impact	Medium impact	Medium impact	• Banks will need to engage in proactive regulatory communication to obtain supervisory non-objection before providing stablecoin-related services • Payment processors and stablecoin issuers should leverage their regulatory communications teams to analyze impacts from digital currency legislation; they may also proactively engage with their regulators in the rulemaking process
Compliance				
• Compliance framework updates to effectively manage specific compliance obligations posed by stablecoins, including privacy, consumer protection, and other key impacts posed by stablecoins	High impact	Medium impact	Medium impact	• All market participants may be impacted by consumer protection and compliance requirements • Stablecoin issuers should develop policies, procedures, and compliance programs akin to banks with a compliance program that effectively addresses the new obligations potentially arising from obtaining a bank charter, if required • Banks may need to update their compliance framework for stablecoins, potentially requiring major changes given the regulatory uncertainty and new risks that come into scope • Banks need to demonstrate an understanding of different compliance obligations related to stablecoin activities

High impact   Medium impact   Low impact   No impact

Potential Regulatory Expectations	Applicability to Participants			Considerations (Based on Industry Experience)
	Stablecoin Issuers	FDIC-Insured Depository Institutions	Payment Processors	
				• 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 (money transmitter licenses) • Issuers, payment processors, and banks that play a critical role within a stablecoin arrangement may be restricted from lending customer stablecoins and may be subject to appropriate risk management, liquidity, and capital requirements as well as to limits regarding the affiliation with commercial entities and the use of customer transaction data • 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 • Identifying and assessing money laundering (ML) and terror financing (TF) risks • Transaction monitoring, including SAR reporting • Recordkeeping				• 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 and sanctions programs are reasonably designed to ensure and monitor compliance with applicable laws and regulations, including the suspicious activity reporting requirements

High impact   Medium impact   Low impact   No impact

Potential Regulatory Expectations	Applicability to Participants			Considerations (Based on Industry Experience)
	Stablecoin Issuers	FDIC-Insured Depository Institutions	Payment Processors	
				• ML/TF risks relating to stablecoins should be identified and assessed before launch and in an ongoing and forward-looking manner by all stablecoin participants; appropriate measures should be taken to manage and mitigate the risks before go-live • If stablecoins are a new product offering, institutions will need to update their existing BSA/AML and sanctions programs • This area will likely remain a significant focus area or regulators in ensuring bad actors are not using blockchain rails or stablecoins to commit fraud or move illicit money • FinCEN, IRS, and other federal functional regulators will continue to increase supervision of stablecoin arrangements; this could lead to improved private sector compliance and/or enforcement actions for non-compliance; enforcement activity would signal to stablecoin service providers and other industry players that they will be held accountable for non-compliance with AML/CFT and sanctions obligations

High impact Medium impact Low impact No impact

Potential Regulatory Expectations	Applicability to Participants			Considerations (Based on Industry Experience)
	Stablecoin Issuers	FDIC-Insured Depository Institutions	Payment Processors	
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	High impact	Medium impact	Medium impact	• A strong corporate governance framework can help issuers and payment processors manage the risks better and demonstrate efficient oversight • Adoption of a Three Lines of Defense 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 • In line with the relevant principles of the IOCSO Principles for Financial Market Infrastructures (PFMI), the participants of a systemically important stablecoin arrangement (SA) should have overarching governance structures with clear and direct lines of responsibility and accountability as well as integrated and comprehensive risk management frameworks; this also applies to SAs whose core functions—stablecoin issuance, redemption, transfer, storage, and exchange—are unbundled and performed independently by different entities/persons

High impact | Medium impact | Low impact | No impact

Potential Regulatory Expectations	Applicability to Participants			Considerations (Based on Industry Experience)
	Stablecoin Issuers	FDIC-Insured Depository Institutions	Payment Processors	
Third-party risk and intercompany governance				
• Up-to-date processes to meet regulatory expectations, including inventory, risk rating, due diligence, and ongoing performance monitoring • Where stablecoin issuers leverage other affiliate services, they will need to consider service level agreements to document performance expectations and controls for oversight and monitoring	High impact	Low impact	High impact	• 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 have and execute contingency plans in case of terminations; this should also extend to performance monitoring • Banks should update their 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. • Stablecoin issuers, payment processors, and banks engaged in stablecoin-related activities should ensure that any third parties that provide critical functions related to stablecoins meet the appropriate risk management standards and are ready for an examination by regulators, if required

High impact | Medium impact | Low impact | No impact

Potential Regulatory Expectations	Applicability to Participants: Stablecoin Issuers	Applicability to Participants: FDIC-Insured Depository Institutions	Applicability to Participants: Payment Processors	Considerations (Based on Industry Experience)
Treasury				
• Capital adequacy and capital management processes demonstrating the ability to withstand significant stress • Liquidity management, including measurement of liquidity and contingency planning • Balance sheet management • Contingency planning	High impact	High impact	Medium impact	As regulatory requirements become clearer, considerations include: • Banks and issuers should analyze how stablecoins may impact their capital and liquidity requirements, and potentially prepare to meet specific capital and liquidity standards that are designed to address safety and soundness and financial stability concerns • 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 • Stablecoin issuers and payment processors might also be subject to liquidity risks due to misalignment of the settlement timing between stablecoin arrangements and other traditional systems, causing temporary mismatches in the quantity of stablecoins available that need to be managed • Regulators will likely further expect significant contingency planning • Issuers and other ecosystem participants need to assess whether the stablecoin provides its holders with a direct legal claim on the issuer, or a claim in the underlying reserve assets for timely convertibility at par into other liquid assets in both normal and stressed times

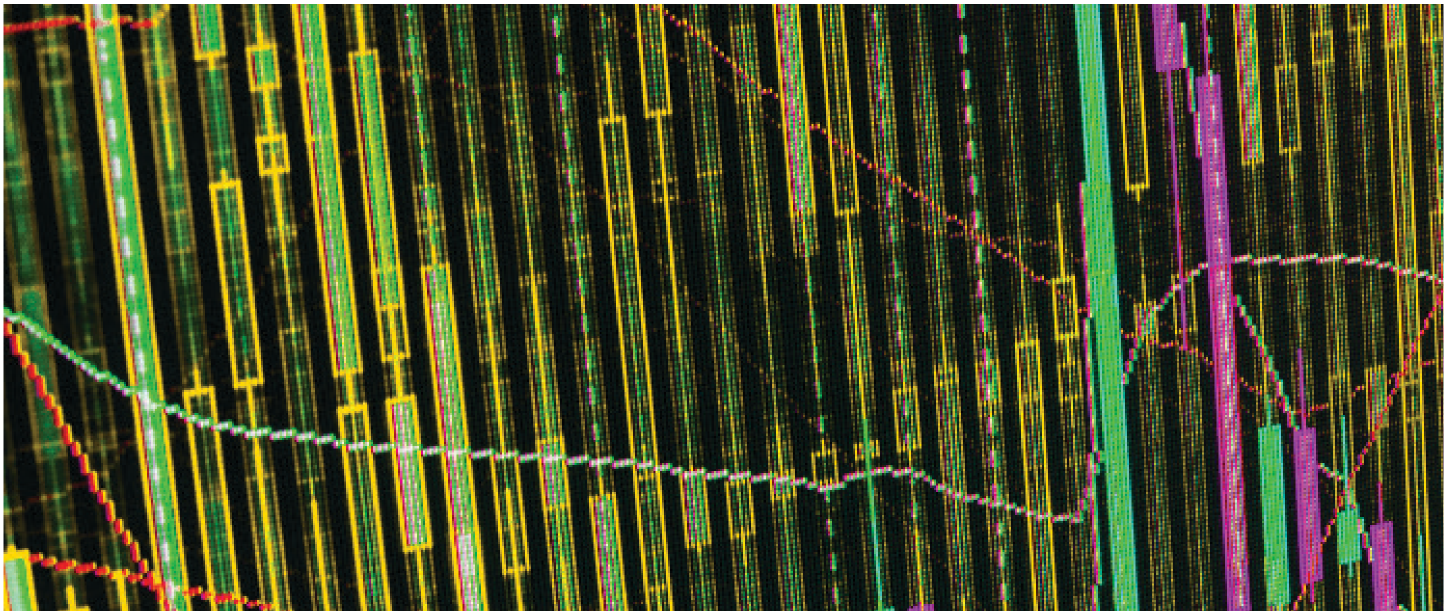
High impact | Medium impact | Low impact | No impact

Potential Regulatory Expectations	Applicability to Participants			Considerations (Based on Industry Experience)
	Stablecoin Issuers	FDIC-Insured Depository Institutions	Payment Processors	
Technology and information security				
Information security & BCP • Disaster recovery and business continuity planning (BCP) • 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 • Entities providing custody wallet services for stablecoins would need appropriate processes to comply with limits on using customers' transaction data
Technology and IT Risk • Broader Technology and IT Risk Management impacts and controls supporting digital currency processes				• Banks, stablecoin issuers, and payment processors should consider existing FFIEC (Federal Financial Institutions Examination Council) expectations relating to Technology, IT Risk, and IT Governance and adapt where appropriate; banking regulators are adopting aspects of this framework to keep pace with digital banking developments and the standards provide a good direction to the range of IT controls and IT governance practices • Payment processes may face integration challenges with existing fiat currency models and services and face novel risks, such as those related to the validation and confirmation of stablecoin transactions and the integrity of the distributed ledger that are utilized to support end-to-end processes • Additional technology vendors may be required to support Tax, Compliance, Risk, and financial processes (e.g., transaction monitoring); these relationships will need to be managed and integrated in overall IT risk management frameworks

High impact   Medium impact   Low impact   No impact

Potential Regulatory Expectations	Applicability to Participants			Considerations (Based on Industry Experience)
	Stablecoin Issuers	FDIC-Insured Depository Institutions	Payment Processors	
Accounting, reporting, and internal controls				
• Regulatory reporting • Financial reporting • Tax information reporting • Accounting and internal controls • Transparency provided by external audits • Income tax treatment • General ledger impact	High impact	Medium impact	Low impact	• Issuers should establish regulatory reporting requirements and related processes, which will include setting up the internal control and quality assurance frameworks to ensure complete, timely, and accurate reporting as done today by insured depository institutions • Banks should update the reporting mechanisms (financial, tax, and regulatory) to include stablecoins in alignment with existing and developing regulatory expectations, update their existing internal controls, and create additional controls (if required) to manage risks due to stablecoins • Entities providing custody wallet services for stablecoins are likely to be subject to additional reporting requirements that may require enhancements to data and reporting frameworks • 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 for 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 • All market participants should clearly define the point at which transfer on the ledger becomes irrevocable and technical settlement happens, and make it transparent whether and to what extent there could be misalignment between technical settlement and legal finality • Market participants should 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 that could be created in case of reversal stemming from the misalignment between technical settlement and legal finality

High impact   Medium impact   Low impact   No impact



About Deloitte's Blockchain and Digital Assets practice

At Deloitte, our people work globally with clients, regulators, and policymakers to understand how blockchain and digital assets are changing the face of business and government today. New ecosystems are developing blockchain-based infrastructure and solutions to create innovative business models and disrupt traditional ones. This is occurring in every industry and in most jurisdictions globally. Our deep business acumen and global industry-leading audit, consulting, tax, risk, and financial advisory services help organizations across industries achieve their blockchain and digital asset aspirations. Reach out to our leaders to discuss harnessing the momentum of blockchain and digital assets, prioritizing initiatives, and managing the opportunities and challenges associated with blockchain adoption effort.

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Endnotes

1 Deloitte, *So, You Want to Be a Stablecoin Issuer?*; September 9, 2021

2 https://www.bis.org/speeches/sp220118.htm; accessed in January 2022

3 https://www.occ.treas.gov/news-issuances/speeches/2022/pub-speech-2022-2.pdf; accessed in January 2022

4 FSOC, *2021 annual report*; accessed in December 2021

5 US Senate Committee on Banking, Housing, and Urban Affairs, *Stablecoins: How do they work, how are they used, and what are their risks?*; video of committee hearing, December 14, 2021

6 OCC, *Chief Counsel's interpretation clarifying: (1) authority of a bank to engage in certain cryptocurrency activities; and (2) authority of the OCC to charter a national trust bank*; Interpretative Letter #1179, November 18, 2021

7 PWG, FDIC, OCC, *Report on stablecoins*; November 2021

8 FATF, *Updated guidance for a risk-based approach for virtual assets and virtual asset service providers* (October 2021).

9 IOSCO, *Application of the principles for financial market infrastructures to stablecoin arrangements*; October 2021

10 Simon Brennan et al., *Implications of digital currencies for bank balance sheets and strategy*; Deloitte, July 21, 2021

11 Ibid.

12. A stablecoin arrangement is an arrangement that combines a range of functions to provide an instrument that purports to be used as a means of payment and/or store of value. To be usable as a means of payment and/or store of value, a stablecoin arrangement typically provides 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.

13. The IOSCO report outlines four overarching considerations to assess the systemic importance of a stablecoin arrangement. The following considerations need to be assessed holistically rather than taking each point as an independent reflection of systemic importance: (i) size – number of stablecoin users, number and value of transactions, and value of stablecoins in circulation; (ii) nature and risk profile of the stablecoin arrangement's activity – type of stablecoin users, type or nature of transactions; (iii) interconnectedness and interdependencies of the stablecoin arrangement (i.e., whether it has significant interconnectedness and interdependence with the real economy and financial system); and (iv) substitutability of the stablecoin arrangement (i.e., whether there are available alternatives to using the stablecoin arrangement as a means of payment or settlement for time-critical services).

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