Branching Out: A Retail Banking Podcast Series

Season 2, Episode 7: Stablecoins and retail banking: New rules, new roles, new opportunities

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Bill Dworsky: Hi, everyone. Welcome to Branching Out, the podcast where we explore trends in retail banking through conversations with leaders from across the financial ecosystem. I'm your host, Bill Dworsky, and today, I am excited about a conversation involving the banking environments for digital assets, cryptocurrency, and more. So, to explore the topic and what it means for retail, I've got a conversation teed up with David Portilla, a partner at Davis Polk, as well as colleague Richard Rosenthal, a colleague and leader here in Deloitte's banking practice.

So, David, Richard, thanks to you both for joining me. Maybe to get started, do you just want to do quick intros? David, do you want to start?

David Portilla: Yeah, for sure. Thanks for having me on. My name's David Portilla. I'm a partner in the financial institutions group at Davis Polk, and I have focused on digital assets and stablecoins for the better part of 10 years. In particular, focused on the intersection of digital assets and stablecoins in the banking industry. And just by way of background, I spent a lot of my career at Davis Polk, but in between stints here, I did spend a few years at the treasury department in Obama administration term one. So, I have a little familiarity with that building and how the government works in Washington.

Bill Dworsky: Awesome. Richard?

Richard Rosenthal: Yeah, pleasure to be with you, Bill. I've been with the firm now 17 years. I lead both their banking regulatory practice and a practice called Business and Entity Transformation, which deals with licensing, new banks, new product launches, digital assets, you name it. I've been kind of at the intersection of regulatory and strategy now for a long time, and I think David and I have crossed paths on numerous client engagements, and frankly, your number, David, I kind of match as well. We've been through a lot of pendulum swings on digital assets, but I've been here for about 10 years and digital assets I think we've had a unique vantage point.

Bill Dworsky: Love it. Well, very cool. Let's start with the GENIUS Act. David, can I just ask maybe for you to start with kind of the 101 on this act for our audience?

David Portilla: Yeah, for sure. The first thing I'll say is that the GENIUS Act and its passage by Congress enactment is a big deal. We don't often have financial services legislation in the United States, and we even more infrequently have bipartisan financial services legislation in the United States. And this is a statute that was passed by Congress with just shy of 20 Democratic votes in the Senate, and I believe over a hundred Democratic votes in the house—and that just shows you how much political momentum there is for stablecoins in Washington.

This administration was focused on stablecoins from the very beginning. President Trump issued an executive order on his third day in office and said it was the policy of his administration to promote the development and growth of dollar-denominating stablecoins around the world. And they delivered. I mean, they were able to get Congress within six months basically to pass a law and have it signed into law.

What does the law do? The law is really the first comprehensive federal statute governing digital assets that we have. It provides a regulatory framework for payment stablecoins that includes standards for how stablecoins themselves should operate, standards for how payment stablecoin issuers should be regulated, and it provides a framework for the balance between federal and state regulation of payment stablecoin issuers. There's a lot of work to do for the regulators to implement the statute, but it's a clear framework, and I think you'll see them and the administration implement it promptly and comprehensible.

Bill Dworsky: Richard, I'm curious, what are you starting to see as kind of near-term reactions, commentary, or things that you're kind of hearing or seeing in the marketplace as an outcome?

Richard Rosenthal: I think David said it's a big deal. The amount of time it took to pass the legislation, that it was bipartisan, that it provides a regulatory framework to be an issuer of a stablecoin. It legitimizes an entire asset class, an entire industry! This was an industry that was struggling for certainty; they were calling for regulatory clarity. In my opinion, it really was almost a wish list for the digital asset industry. And actually, I think right now—I think David would probably share this—that the banking industry is having some second thoughts about some of the provisions in there because it basically creates a mechanism for a lot of nonbanks, technology companies, and others to become issuers of stablecoins, and in a backdoor kind of way offer interest on those stablecoins.

So, to kind of bring it into frame, I like to think about stablecoins as both a rail. So, it's a payment rail in the way that we think about wire ACH, but it's also kind of like the cashlike instrument for an on-chain asset. And so, think about the way cash is used, think about its role and collateral in a range of normal transactions. If you can imagine a world where a lot more is on chain or on blockchain rails, like equity is being issued on chain or moving money on chain, then having a cashlike instrument is very important.

So, the market reaction—I think the speed at which this thing happened caught a lot of people off guard. And I think for many—the nonbanks, fintechs, technology companies—they have been waiting for this moment. So, some of them have been filing charters, trying to get set up for a structure to enable them to be issuers that are GENIUS compliant, and David and I can talk about that. But a range of companies are thinking about it: How do I use a stablecoin within my business model? If I'm a corporate, do I get some cost savings? If I move money cross-border, is that a better way to do that? Think about platform technology marketplace companies: Do I motivate and incentivize behavior? If I give someone a stablecoin and I ask them to use it, maybe I can get them some rewards, I give them some money back, I can incentivize behavior. So, this is really a paradigm shift.

I think there's a lot of interesting business models being created. I think there's a lot of people that see opportunity to arbitrage or set up a little moat within these regs. I think you see a couple companies that see a once-in-a-lifetime opportunity - "Now is my time to get my charter, now is my time to try to make a run at the payment systems, now is my time to try to get my share of the banking moat that banks enjoyed."

I think our banking friends are really trying to think about how they could protect their business model, how they enable their clients. I think the one thing, Bill and David, that we all need to look at is use cases—real utility, real adoption. I still think there's some work to be done on friction, on tax and accounting clarity, and the real underlying resiliency of these rails, to make sure that we have the potential adoption that some people think. So, we're kind of in this frenetic energy, a little FOMO in the market. People are trying to figure this stuff out, and that's why I'm sure, David, you feel the same. It's a very busy time right now.

David Portilla: I want to pick up on what Richard said about use cases because at some level, that's the big question: What are the use cases for payment stablecoins beyond the use case that's most prevalent today, which is as a settlement currency on a crypto asset exchange, on a digital asset exchange? Right now, total dollar-denominated stablecoins outstanding is just south of $3 billion. Secretary Bessent has said that he could see the market easily surpassing $2 trillion of stablecoin outstanding, and there's other estimates that says it could be $4 trillion to $5 trillion stablecoin outstanding.

And I want to point out or underscore one of the points Richard made about incentives. The core structural feature of a stablecoin is that it's a dollar-denominated asset that's pegged to $1 and is backed by reserves. For the GENIUS Act, those reserves have to be bank deposits, central bank reserves, or short-term treasuries. Well, the reserve assets earn income, and a stablecoin issuer can use that income to incentivize use of the stablecoin in different environments. And we can get into more specific examples, but I think as it relates to use cases and the growth of the industry, to the extent consumers, ultimate end users, are incentivized to use a stablecoin—economically incentivized to use a stablecoin—you're paying for the creation of a use case, and that will have a self-reinforcing effect in the sense that more people will hold payment stablecoins, the reserve asset pools will grow in the aggregate, that will create more income off the reserve assets; that can be used to incentivize further use.

Bill Dworsky: So, these are things like starting to see rewards programs that are tied to stablecoin usage and other things like that that are kind of eye-catching for consumers to encourage adoption. Are there any particular products that you think, hey, this is starting to get traction a lot faster than maybe even some thought they might that are kind of built on that foundation?

Richard Rosenthal: I mean, you look at the examples today in the public space. You can go to Coinbase and you can get USDC and you can get some awards on that. Again, I think David's right, though—it's largely been the crypto user that's looking for a kind of on-chain cash instrument to get in and out of trading, or they have some crypto usage to go. I think the PayPal stablecoin's interesting because it's embedded in commerce, it's embedded in flows of retail usage, Bill, and for that to kind of grow like it did, I think that's an interesting testament—and they are offering rewards.

One finer point I would say is we haven't talked about cross-border and the role of USD as an inflation mechanism. And really stablecoins found their initial premise—and I think people gravitate most to how long it takes to settle money cross-border and how costly and expensive that is.

So, in particular, if you have a corporate B2B transaction or a retail flow where you have those more hops or the dollar can play a role as an inflation hedge or as maybe a better currency mechanism than a low currency, then I think that you're going to see more vulnerability of those flows than just domestic–domestic.

David Portilla: And I would just underscore the point about accessibility for consumers today not being as easy as it's likely to be in the future. And this is a podcast focused on retail banking. In my opinion, one opportunity for the retail banking offering is to offer a consumer a wallet in your bank's app that shows stablecoin balances, and to allow them to easily move between deposit balances, stablecoin balances, and to transfer or transact using those stablecoin balances. And then this goes to the point about use cases, too: As it's easier for consumers to access the stablecoin product and use the stablecoin product, it's easier for use cases to develop because that consumer can log into their bank app and simply use stablecoin, and then there are others—whether there are businesses or other consumers—that can receive a stablecoin in their bank app.

And I think that potential could really be a game changer, and it also raises the question of whether some of these economic models we've talked about in terms of sharing the reserve asset income would be something that you see banks participating in, in that context.

Bill Dworsky: So, it feels like some banks are very aggressively experimenting, testing, trying to place bets about new business model opportunities, Richard, to your point a little bit earlier. Some maybe on the defensive a bit more? One thing that we talked a lot about is what's the impact on traditional deposits for banking institutions? Can you talk a little bit about what some of the potential implications could be for banks that are very oriented around the sort of bread and butter of gathering retail deposits in their local neighborhoods?

Richard Rosenthal: And this is why there's a good number of debates happening in the industry right now about some of the fire provisions in the GENIUS bill, and the regulators are right now currently writing the regulation and there's been a lot of focus on the can you pay interest, or closing that loophole, as rewards. And then I think also the focus on payment systems access. Banks will have a role to play in banking the reserve of a stablecoin.

So, to go back to David's breakdown, there's still cash, treasuries, and things of that nature. Banks are generally good custodians or good locations to support the management and protection of those assets, and a stablecoin, people want to get that into dollars. And so, every stablecoin I would estimate has about 10% in readily available cash. So, when someone goes and redeems a stablecoin, you can give them cash. Well, guess who provides that ramp? Banks. And so, there is a role where banks can be banking the digital asset ecosystem, and that's one area I'm spending a lot of time with clients on. OK, you don't have to be an issuer, but you've got an opportunity to provide support to this ecosystem—and oh, by the way, you can offer those same customers loans and other products. That being said, if you imagine a nonbank that's an issuer of a stablecoin also having access to the payment system, I think it starts to get really interesting. There's less tendency potentially on the role banks play because remember, banks offer deposit insurance, they have a unique role with the Fed Discount Window, the Fed account. And I think if some nonbanks get access to that through the GENIUS Act, through this charter (and David may have some thoughts here), you could start to see a world where money starts getting reallocated and deposits do have experienced some cannibalization.

In that same study that Secretary Bessent did on the growth of stablecoins, they did analyze that some deposit DDA accounts could experience some attrition. And so, I think you have to start analyzing what type of accounts are most vulnerable. Are those corporates that tend to want to move money cross-border? Maybe. Are all deposits created equal? No.

I'm sure, and in this podcast, Bill, we focused on some of those aspects. I do think it starts with looking into that customer base, what are your clients asking for in terms of services, and if you don't have that product rail or you don't have that wallet, then I do think there's some risk on attrition there. I do see a world where people start allocating some funds to this asset and rail, and I think banks need to have an answer. And that's why most projects, most discussions have centered around let's call it a "no regret" capability, which is that wallet, that account, and potentially some banking of this ecosystem. David, do you agree? Disagree?

David Portilla: Yeah, I mean, I largely agree. If you see a market that goes from south of $300 billion in stablecoin outstanding today to $2, $3, $4 trillion of stablecoin outstanding as the different estimates have suggested, I think it's almost inevitable that you're going to see a shift in some balances from deposits to stablecoin because where are those balances going to come from? I don't think they're going to come entirely from deposits, but I think you'll see a shift to some degree.

I also agree wholeheartedly with what Richard said about the interaction between the ability to offer a wallet capability and any individual institution's deposit experience in terms of deposit outflows. Because I don't think we know yet how stablecoin balances will be held in terms of the amount and length of time a consumer will hold a stablecoin balance before transacting. But if a bank has a wallet, they can keep those deposits for the consumer in the deposit account and move them to stablecoin as and when requested by the consumer. Whereas if you don't have the ability to do that, you could see those deposits leaving the bank entirely and going somewhere else where the consumer has that capability. So, I think there's an industrywide question of transfer of balances from deposits to stablecoin, which is one thing, and then I think there's probably institution-specific experiences based on how institutions react to the current environment and the changes that are on the horizon.

Richard Rosenthal: David, I think that's a great point. It goes back to, I think, Bill, the work we're doing right now, which is a little bit of game theory. But thinking about the way customers will want to perceive these balances and rewards. David, you're on the money; I think we don't know everything yet. But we do know the following: We know a deposit account has FDIC insurance, and we know a stablecoin account will not. We know that they both will have different yield characteristics. We both know that you could probably do some pretty cool stuff with stablecoin because they're programmable. I could give you interest every day, I could do different things. I could define properties, and then automate certain things. So, there's going to be a lot of interesting things people do. But the way David just laid it out is actually I think the way most banks are talking about responding, which is I don't need to cannibalize a deposit account. If someone wants to use stablecoins, I can do an automatic top-up to that account of that amount, move that money, and then enable that transaction.

Now, the customers say I want to keep a thousand dollars in stablecoins; I don't really care about FDIC insurance or whatever. But I think you've got to at least do that work. You've got to lay that out. There's a lot of people that are not there yet, Bill—where the speed of which this happened plus everything happening in the world, with AI and the regulatory changes we have? We are in an information overload time, and I think this whole conversation we're having kind of went under the radar.

David Portilla: Yeah, I agree. I would say it was hiding in plain sight in the sense that if you were paying attention, it wasn't under the radar, but not everyone was paying attention including to some of the things the administration said about their objectives of really facilitating the growth of the stablecoin ecosystem. And so, you have a government that's fully behind this ecosystem growing, and I agree with Richard that there are a lot of institutions that are not actively figuring out how to respond, and I think a lot of that hesitation comes from an uncertainty or a doubt of what the use cases will be. But my own opinion, which is maybe a little bit of a hetero ops view as compared to that maybe prevailing view in the banking industry is that the use cases will develop as balances grow, and as balances grow there's more incentive for people to find new use cases, and that will all happen before we know it. And we don't know exactly what the use cases will be, and we don't know exactly what are the venues where this will be—a payment instrument that's accepted and what the incentives will be for a consumer to use it—but I think you're going to have a lot of market participants seeking to find those outlets.

Richard Rosenthal: A lot of bright people, very bright people—and a government that is fully motivated. That's the point we both are underscoring is—I'm of the same line, too.

Bill Dworsky: If we zoom out from the timeline history, I think there are a number of other examples where similar types of, like, "What are the use cases? How is this really going to be adopted?" But David, like you were saying, the more consumers, the more people you get engaging with the new innovation, the more ideas start to come for how it will be used or how can it be used or where it might be valuable, and there's a positive reinforcement mechanism to kind of propagate that usage and kind of grow the platform, grow the network, and the number of participants using it, so to speak. So, what do you think is the one biggest uncertainty that needs to be resolved or that you hear clients respectively asking a lot of questions about in order to kind of inform forward action or making moves, so to speak—either uncertainty about specific parts of the GENIUS Act or otherwise? Do you think there are kind of one or two big questions that you think need clarification or resolution on?

David Portilla: Look, I would say I'm going to be a little glib at first, but first, no one even knows how to apply to become a permitted payment stablecoin issuer yet because we're waiting for the rules on applications, so that would be good. Now, I said it's glib because it's unfair. Of course, the agencies are hard at work on it, and it's only been few months since the bill became law. There are some legal questions in terms of interpretive issues that the banking agencies will need to—we're talking about the banking sector here. I'll just list a few.

One is what's the capital treatment for holding a stablecoin on your balance sheet as principle? Two is, I believe it to be the case that it's permissible for a bank or bank holding company to hold a payment stablecoin on its balance sheet as principle, but I think having some crystal clear clarity about that, it makes sense. And thirdly, where in a banking organization could you see stablecoin issuance happening structurally? What type of legal entity? So I think those are some, obviously a dozen issues, but those are some of the ones that I think are really important and front and center.

Bill Dworsky: Well, this has been great. We've covered a lot of ground here. I just wanted to close with one last question. How long do you think we'll still have paper currency going into the future? 2030? 2040? What do you think?

Richard Rosenthal: I think people have been talking about checks going away and all these things and paper. I would say probably much longer than 2030. I would be kind of more on the higher end. I still think there's a lot of businesses and people, and again, you have to think about the politics of this. I think it has a role and people like it. You've probably got a better view than I, Bill, in terms of your take, but I would be on the longer side. I don't know. David, what do you think?

David Portilla: Yeah, there's a lot of personal trainers that like to get paid in cash. So, you're really talking about fighting against a lot of momentum there. Alright, well, we won't take any specific yearly forecast then, but yeah, I think it'll be here longer than most folks expect to.

Bill Dworsky: Alright, love it. Well, thank you very much to you both for your time, and thanks for our listeners out there for tuning in to today's conversation.

Thanks also to our friends at Hangar Studios, and if you're looking to go deeper on some of the topics we talked about today, check out our podcast webpage online at deloitte.com/branchingout where you'll find some short show notes and relevant links from the conversation. Also, as always, if you have ideas, suggestions, other feedback, just drop us a note, branchingout@deloitte.com. We look forward to exploring the future of retail banking with you again soon.