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FACT SHEET

The Crypto Stablecoin GENIUS Act Hurts All Americans by Undermining the Economy, Financial System, and Monetary Policy

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Just last month the so-called GENIUS Act was signed, creating the first U.S. law dealing with stablecoins (which we have referred to as unstablecoins). However, while crypto and stablecoin advocates claim this law regulates stablecoins, that is a fiction to the point of being a fraud on the public. That's because the law gives the impression, but not the reality, of meaningful and proper regulation due to industry-friendly provisions, loopholes, ambiguities, and careful phrasing inserted throughout the law. As a result, it is an anti-consumer, anti-investor, anti-financial stability, and anti-capital markets law that will hurt Main Street Americans by undermining and threatening the economy, financial system, and monetary policy.

The law is, however, a big win for the crypto industry because it can now claim to be subject to federal regulation, which will give stablecoins an aura of legitimacy. That's why the industry spent so heavily to get the law passed. Crypto's marketing machine will no doubt trumpet that "regulation" and "approval" endlessly - despite there still being no legitimate purpose for stablecoins (or cryptocurrencies more generally). Not coincidentally, this was the strategy of FTX and Sam Bankman-Fried before its bankruptcy and his criminal conviction, as Reuters brilliantly detailed here: "How FTX bought its way to become the 'most regulated' exchange."

As is well-known, customers and investors rely on the government to properly regulate the financial industry and often let their guard down when they believe that a firm, asset, activity, or market is regulated. That's why, for example, so many in the crypto industry falsely and misleadingly suggest that their activities are insured by the FDIC, the gold standard of government regulation and protection since the 1930s. Lulling Americans into a false sense of security by making them think stablecoins are properly regulated was the real aim of the industry's push for a law to be passed.

However, this law does nothing to change the fact that stablecoins (and all crypto) are nothing more than novel, very high risk, volatile financial investments that will increase opportunities for consumer fraud and criminal activities, undermine our currency and monetary policy, and amplify already substantial financial stability risks. The public will bear these tremendous costs, while the industry will get rich moving billions of dollars from Americans' pockets to their bonus pools.

That is what is really at stake here. Because of the structure of stablecoins and the assets issuers hold, stablecoins make worse the type of financial instability that has been repeatedly inflicted on the American people by the financial industry – in the 2008 Financial Crisis ("2008 Crash"), 2019 turmoil in markets for repurchase agreements, March 2020 financial market turmoil, and 2023 banking crisis. All these events resulted from financial industry activities that enriched Wall Street and financiers, but caused instability that necessitated massive government intervention, including the Federal Reserve ("Fed") providing huge bailouts to stabilize the markets through "special facilities," which is just a fancy way of saying bailout vehicles.

As with these events, the reckless, thoughtless policymaking of the GENIUS Act will make our economy and financial system more unstable and introduce unnecessary, confounding complexities into the management of our economy and the implementation of monetary policy.

The major issues of the GENIUS Act related to financial, stability, the economy, and monetary policy are discussed below, and Better Markets has a lengthy dedicated webpage to all things crypto (with subheadings Regulatory Agencies, Crime and Fraud, Congress and Legislation, Influence Peddling, and FTX), which includes our Fact Sheets on the GENIUS Act here, here and here.

Stablecoins Will Increase Risks to Financial Stability

Stablecoins have their name because they are supposed to be redeemable for U.S. dollars one-for-one on demand. According to the GENIUS Act, stablecoin issuers are to maintain this peg by holding a reserve of "safe assets" that can be sold quickly for little-to-no loss to meet redemptions of funds on demand. That is, a pool of truly safe assets with stable value should result in customers getting their money back on demand even if many customers redeem all at once and the reserve assets have to be sold in large quantities.

However, the basic structure of stablecoins is very similar to money market funds, which repeatedly have caused financial stability risks, leading to their bailout in 2008 and again when COVID-19 hit in early 2020. Similarly, if stablecoin issuers are not able to honor a request to redeem a stablecoin one-for-one with US Dollars, or even if users simply lose confidence in a stablecoin issuer's ability to honor such a request, this will lead to a run – a self-reinforcing cycle of customer redemptions and large-scale sales of reserve assets.

Not only is there the risk of runs by stablecoin customers, but there is also significant volatility in the values of the assets that are meant to support the stability of the coins. The assets that the GENIUS Act allows to be held in reserve to back stablecoin issuers are far from safe, particularly given the minimal safeguards in the Act. According to the Act, "safe" reserve assets can include not just debt securities issued by the U.S. government (Treasuries), but also money market fund shares, uninsured bank deposits, and repurchase agreement loans. All these assets have experienced crises multiple times that necessitated bailouts and intervention from the Fed by pouring trillions of dollars into financial markets as a "backstop."

Most recently, uninsured bank deposits were bailed out in the spring of 2023, when large depositors – many of which were large crypto companies – rapidly withdrew funds from Silicon Valley Bank ("SVB") and others. Depositors that were bailed out included the stablecoin issuer Circle, which had $9 billion in mostly uninsured deposit exposure to US banks, including $3.3 billion at SVB. Not only were depositors bailed out, these failures resulted in contagion within the banking system that required the Fed to put in place a special facility to backstop bank deposit withdrawals.

Additionally, the GENIUS Act permits nonbank companies (e.g., Amazon, Walmart, Meta) to apply for "licenses" that would provide them with many of the benefits of the taxpayer-supported banking system without any of the regulatory or supervisory guardrails that are designed to prevent excessive risk-taking. Furthermore, stablecoins feature unique cybersecurity vulnerabilities and illicit finance risks that exacerbate financial fragility, such as prominent use in ransomware attacks, outsized involvement in consumer scams, and frequent use by malicious state actors to circumvent the application of sanctions.

Taken together, these issues greatly increase the potential for financial instability that would have to be addressed by the Fed as it has in other episodes of severe financial market stress. Importantly, stablecoin instability could cause Treasury market instability, since it is likely that a large share of stablecoin reserves will be Treasuries. Under stress, stablecoin issuers would be forced to sell off large amounts of Treasuries from their reserves to meet redemptions. Treasury markets already have experienced multiple episodes of instability and illiquidity, so much so that there's actually talk of setting up a bailout mechanism for the big hedge funds that are significant dealers in the Treasury market.

While having stablecoin issuers hold large amounts of Treasuries might meet the Treasury Department's short-term goal of finding more buyers of Treasuries, stablecoin issuers – like hedge funds – would be just one more unstable buyer that would sell their Treasuries at the first sign of stress. In fact, unstable holders of Treasuries (hedge, mutual, money market, and exchange-traded funds) now make up nearly a third of the Treasury market, up from 14 percent in 2007.[1] This share will grow as stablecoin issuers grow, exacerbating Treasury market instability and the necessity for Fed action.

Stablecoins Undermine the Banking System and Lending to the Real Economy

If stablecoin issuers become large as a result of the GENIUS Act, this would ultimately slow the economy and increase prices, making the Fed's mission of meeting its dual mandate more

[1] Author's calculations based on data from the Federal Reserve's Financial Accounts of the United States.

difficult. Put simply, a dollar of savings put into a stablecoin is a dollar that is not deposited at a bank. Deposits are vital to the banking system and the real economy because banks primarily fund their activities—such as lending—with deposits. Therefore, fewer bank deposits mean less bank lending to the real economy, which is very problematic since banks are the safest, cheapest, and best source of lending to Main Street Americans.

However, by legitimizing stablecoins, the GENIUS Act will result in money moving away from bank deposits and into the crypto ecosystem. This movement of funds will be boosted by stablecoin issuers taking advantage of loopholes in the GENIUS Act to pay interest to their customers, similar to the way in which money market funds attract funds away from bank deposits, especially from households.

US Dollar-pegged stablecoins already reached an estimated $250 billion in size prior to the legislation being signed into law. This number is poised to grow very quickly, especially with the loophole on paying interest to customers. To provide some context, money market funds – which directly passed along the Fed's massive rate increases that started in early 2022 – grew in size by 45 percent between then and the end of last year. By comparison, bank deposits basically remained flat over that same period.

If the growth in stablecoins outpaces bank deposits, there will be less availability of the type of long-term, affordable loans banks make to boost the real economy. Economists at the Fed Bank of Kansas City estimate that an increase in stablecoins to just $900 billion would result in a reduction in bank lending of $325 billion. Ultimately, this could drive up costs for all borrowers, including consumers and small businesses. Slower growth and higher borrowing costs would drive up unemployment and prices, making it more difficult for the Fed to meet its dual mandate of maximum employment and stable prices.

Stablecoins Complicate the Implementation and Potentially Diminish the Impact of Monetary Policy

Stablecoins would complicate the Fed's implementation of monetary policy and potentially diminish its impact. As discussed, whether stablecoin issuers are Wall Street banks, Big Tech firms, or shadow banks, they likely will hold large amounts of Treasuries and dollars as part of their reserves backing the stablecoins. As investors flow in and out of stablecoins – and especially as they flow out in large quantities during periods of stress – supply of dollars and Treasuries in markets will fluctuate, impacting both the cash Treasury markets and markets for repurchase agreement-based short-term lending.

Stablecoin issuers likely would hold short-term Treasury bills as part of reserve assets to match the short-term nature of the redeemable-on-demand stablecoins, similar to money market funds. As discussed, supply changes in markets would impact the market-implied interest rates for Treasury bills as customers flow in and out of stablecoins. The Fed would have to step in to control these rates if they start to move away from its policy goals, especially when fire sales under stress cause these rates to spike.

Additionally, the interest rates offered by stablecoin issuers to stablecoin customers as well as the rates issuers charge to borrowers in repurchase agreement loans would directly affect and complicate how the Fed manages its policy rates. That is, stablecoin rates would compete directly with the rates the Fed controls through its financial market operations, largely executed through financial transactions with banks and other “traditional” financial institutions. If stablecoins become large enough, they could sway market rates, forcing the Fed to intervene in markets to maintain its policy targets for rates. And if banks become issuers of stablecoins, that may decrease their demand for central bank reserves, a key tool the Fed uses to control policy rates.

What makes these effects worse is that because the Fed is largely excluded from the oversight regime for stablecoin issuers, it will also have less insight into market movements as well as risks in the stablecoin ecosystem and their implications for the financial system. The global nature of crypto, the ability of non-financial firms to issue stablecoins, and the lack of money laundering controls make these stablecoins even more opaque and out of the control of the Fed or even other private financial institutions.

Conclusion

The GENIUS Act is a reckless piece of legislation that is nothing more than a giveaway to the crypto industry. The law gives the impression, but not the reality, of meaningful and proper regulation, but it contains multiple industry-friendly provisions, loopholes, ambiguities, and careful phrasing inserted throughout the law. These allow stablecoin issuers to attract customers while engaging in very high-risk activities that undermine and threaten financial stability, the economy, and monetary policy. For example, the gaping loophole that allows issuers to pay interest to their customers was inserted despite the recognition that this should not be done for multiple reasons, including that it attracts depositors away from banks, undermining the banking system and lending to the real economy. Ultimately, the growth of stablecoins as a result of this legislation will hurt all Americans, and the public will bear these tremendous costs, while the industry will get rich moving billions of dollars from Americans’ pockets to their bonus pools.

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Better Markets fights for the economic security, opportunity, and prosperity of the American people by working to enact financial reform, to prevent another financial crash and the diversion of trillions of taxpayer dollars to bailing out the financial system.

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