DIGITAL ASSETS AND COMMUNITY BANKS

ICBA CAPITAL SUMMIT 2022

Wider adoption of cryptocurrency is altering global digital commerce and the global financial system. Unregulated or lightly regulated cryptocurrency poses serious threats to privacy, consumer protections, and financial stability resulting from increases in money laundering, terrorist financing, and fraudulent activity. Unregulated cryptocurrency threatens to disintermediate community banks and undermine their ability to provide funding to support local economic activity, growth, and development.

The Rapid Growth of Cryptocurrencies and Other Digital Assets

Digital assets have experienced rapid growth. From approximately $16 billion in 2016, the combined market capitalization of digital assets peaked at $3 trillion in November 2021, though it has since dropped below $2 trillion. The uses of digital assets are also expanding. Cryptocurrencies are expanding from a niche investment class to function as means of payment and stores of value. Several crypto companies are developing products to enable crypto payments for consumers and businesses.

Some community banks are beginning to explore offering cryptocurrency products and services to meet customer demand, such as cryptocurrency debit card rewards programs or custody services for cryptocurrencies. Numerous financial service providers and fintech companies now offer consumers and businesses access to cryptocurrency-related activities, such as investments, lending, and custodial services.

Stablecoins

Stablecoins are a type of digital asset that attempts to maintain a stable value by being pegged to a national currency or backed by assets, such as commercial paper or commodities. ICBA urges policymakers to develop a consistent regulatory definition and framework for stablecoins and other digital assets that preserves the separation of banking and commerce, which is threatened by Big Tech firms operating payments systems and industrial loan companies that serve as full-service banks without adequate oversight.

Decentralized Finance (DeFi)

DeFi is a growing ecosystem of financial applications that run on public blockchains and attempt to replicate traditional products and services like payments and lending without the use of centralized parties, such as banks, insurance companies, or brokerages. DeFi threatens to disintermediate community banks and create a shadow banking system filled with unregulated platforms that pose risks to consumers, the financial system, and U.S. national security.

Risk

Limited regulation and oversight applied to the cryptocurrency marketplace and transactions mean that consumers and investors that use or hold cryptocurrency are exposed to significant risks, including highly volatile fluctuations in value. Cryptocurrencies also present several operational risks and concerns.

Need for Regulation

Cryptocurrency should be subject to a regulatory regime and oversight comparable to the multitude of regulations applicable to traditional, functionally similar payments products and services offered by the banking system.

ICBA OPPOSES THE CREATION OF A U.S. CENTRAL BANK DIGITAL CURRENCY (CBDC)

A central bank digital currency (CBDC), under consideration by the Federal Reserve and the Biden Administration, could fundamentally change the structure of the U.S. financial system, altering the roles and responsibilities of the private sector and the central bank. Under an intermediated model contemplated by the Fed, "the private sector would offer accounts or digital wallets to facilitate the management of CBDC holdings and payments. Potential intermediaries could include commercial banks and regulated nonbank financial service providers and would operate in an open market for CBDC services." ICBA's serious concerns with a CBDC are described below.

Loss of Community Bank Deposits

As a liability of the Fed, a CBDC positions the Fed as a direct competitor for bank deposits that fund lending. The Fed concedes that a CBDC "substitution effect could reduce the aggregate amount of deposits in the banking system, which could in turn increase bank funding expenses, and reduce credit availability or raise credit costs for households and businesses." In other words, a CBDC could create an outflow of deposits from community banks with a direct and adverse impact on credit availability. Depositors may prefer CBDC over bank deposits in a crisis.

A CBDC Would Not Accomplish the Policy Objectives the Fed has Identified for a "Digital Dollar"

In a recently published consultation paper, the Fed established goals for a CBDC. In practice, a CBDC would accomplish few of these goals. Notably:

- **Inclusion.** The Fed has not articulated how a CBDC would promote financial inclusion. ICBA believes that the best solution to the unbanked is to leverage community banks. A CBDC would not enhance their ability to reach the unbanked.
- **Monetary policy.** Demand for CBDC would balloon the Fed's balance sheet and thereby distort its ability to effectively conduct monetary policy to control inflation and promote full employment.
- **Privacy.** The Fed has not made a compelling argument that CBDC would enhance privacy. There is a fundamental conflict between privacy and efforts to use a CBDC to prevent financial crime.
- **Compliance Burden Without Revenues.** In an intermediated model, banks would be saddled with all of the customer service, know your customer (KYC), anti-money laundering (AML), privacy protections, sanctions screening and other compliance burdens with no clearly identified revenue stream to compensate banks for these services. The Fed proposes that banks would compete with regulated nonbank financial service providers and would operate in an open market for CBDC services. This could introduce regulatory arbitrage risk and unfairly advantage these nonbank providers if they are not regulated as stringently as banks.

Alternatives Provide a Better Route to Achieve Policy Goals

The FedNow service, expected to launch in 2023, will enable financial institutions of all sizes to provide safe and efficient instant payment services in real time, 24x7x365. FedNow provides many of the benefits of alternative payments rails without the risk and will accomplish many of the stated goals of a CBDC. FedNow must be given a chance to work and be evaluated in the market before a CBDC is considered.

The Role of Congress

Congressional approval would be required to create a CBDC. Congress must thoroughly examine the fundamental question of what problem a CBDC is actually trying to solve. A CBDC would be an experiment in which the risks and costs far outweigh any potential benefits for American consumers and businesses and the broad economy. ICBA opposes the creation of a U.S. CBDC.