Transcription

**CSBS | STATE OF THE SYSTEM | GENIUS ACT**

## Episode Transcript

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Yevgeny Shrago (00:00):

What's the difference between a stable coin and a tokenized deposit? The difference is a tokenized deposit. It's a deposit. It sits on a bank's balance sheet. It has deposit insurance, but by tokenizing it, you essentially put a claim on it that can be transferred via the blockchain. The challenge is that it has to live on a bank's balance sheet. A stable coin can be transferred to anyone and is a stable coin. But for a bank to move a tokenized deposit out of its balance sheet, it has to have some kind of relationship with the other banks that other customers use.

Kyle Thomas (00:36):

You are listening to the State of the System, the podcast that brings clarity and perspective to financial regulation. Welcome to State of the System, the podcast from the conference of state bank supervisors. I'm your host, Kyle Thomas, senior Advisor for Policy and innovation. In this show, we explore the intersection of innovation and stability in today's fast changing financial services landscape. Digital assets in particular, stable coins have been one of the sources of that innovation, and it's gotten a lot of focus, not only here in Washington, but around the country and around the world. There's lots of noise, and I would kind of characterize it as we're in a digital asset stable coin hype cycle right now. But a lot of that conversation tends to be very macro focused. We hear terms like cross-border payments, international settlement, intra bank transfers, et cetera, as a lot of the primary use cases for stable coins and some of these other digital assets, but that's not the focus of today's conversation. What we're going to talk about today are real world takes from the perspectives of the people that we work with at the conference of state bank supervisors, which is state regulators and the institutions that they supervise often community banks. My guest today is Yevgeni Rego. He works in our policy and supervision business unit. He's a recent inductee into the CSBS team. And so Yev, welcome to the show. Why don't you tell us a little bit about yourself? Where did you come from and how did you develop this expertise and perspective around digital

Yevgeny Shrago (02:05):

Assets? Thanks so much, Kyle. Excited to be here. My background is in financial regulation broadly. I've been at the CAPB, I've been at treasury. I've been watching these markets with a lot of interest for over a decade, but most recently I came from the Commodity Futures Trading Commission. That's the federal derivatives regulator, and it's the closest thing to a digital assets regulator that we have in the United States at the federal level right now, of course, the states have been regulating digital assets for a decade plus, and so we have been watching fraud in crypto markets. We were watching the development of trading in these markets and it was the most exciting and important thing going on, and we continued to just monitor it. And so when this opportunity to join CSBS came up to focus on these issues, I had to jump on it.

Kyle Thomas (02:51):

So glad you did. We're lucky to have you. Yeah. So let's jump in. Let's talk about stable coins. Obviously we're going to cover a lot of ground in this episode, but I think it maybe makes sense to start out with at the high level, grounding the audience a little bit on what's the use case here, what are we doing with stable coins, what do they do for us? And so can you describe in whatever terms you got, the kind of problem we're trying to solve and what the use case around stable coins is as you see it?

Yevgeny Shrago (03:15):

Sure. I'll give you the hype cycle first and then we'll get into the reality. Stable coins are maybe the most pure way to realize the promise of the blockchain, which is fast, cheap, peer-to-peer payment. So when I say fast, I mean that instead of spending days to send money internationally, you can send money to anyone in just a few seconds cheap instead of 15 to $50 to send a payment to a different country. It can cost less than a penny to send it. And so that's a big opportunity and it can be sent to people who don't have bank accounts. The global remittance market is often money being sent from the US to other countries, and so you don't need to have a bank account to get money on a stable

Kyle Thomas (03:59):

Coin. Okay. So it's money movement.

Yevgeny Shrago (04:02):

Money Movement, that's what we're talking about here. And big companies, they want to move money around. They might need to move money from one country to another across time zones and stable coins allow that to happen quickly as opposed to waiting for banks to be open in both places.

Kyle Thomas (04:14):

Okay, that makes sense. So that's kind of a definition of what the use case is. Give us a sense of the market for this and the market and maybe the scale that we see today because as you mentioned in your opening remarks, this innovation is a way to harness the blockchain to solve the payments problem that exists globally, also domestically. And as such, this innovation has not just started here in the last couple months. It has been around for a little while. You mentioned experience regulating this and the states have been regulating companies that have been getting into this. But where are we at in the scale adoption? Who's using it?

Yevgeny Shrago (04:46):

Sure. So first off, it should be important to note that when we talk about stable coins, we're really talking about US dollar denominated stable coins. It's like 99% of the stablecoin market. And that market, it's about $30 billion in transactions daily. And there's about $300 billion in outstanding stable coins. Market is really dominated by two big companies. First one is a company called Tether. They're based in El Salvador. They're sort of what we might call the OG original stablecoin issue since 2014. They issue about 180 billion. The other one is a company called Circle in New York. They issue a stable coin called USDC, about 75 billion. Both of these are what we'd call reserve backed stable coins. So that means that for every dollar of stablecoin outstanding, these companies claim to have $1 in reserve assets. Circle is all in money, market, mutual fund, tether, a mix of treasuries and other things, including maybe some crypto and Bitcoin.

Kyle Thomas (05:43):

Let's pivot. So that's kind of the high level overview. That's kind of the size scale, the use case around this. We spend a lot of time here at CSBS talking to state regulators. Obviously that's who we work for, but also the banks and the institutions that they supervise. And in those

conversations, I think there's a gap. And the gap is essentially how it's been framed to me as what is in this for me as your average community banker in Montana or in Texas or in Florida, or do I need to be thinking about or what is in this for me? What kind of changes to my business model should I be making? Maybe should I be thinking about making or is this just something I need to be monitoring and understanding? Just at a high level tough question, I acknowledge,

Yevgeny Shrago (06:29):

And I'll give you the best answer to that question, which is of course, it depends. It depends on your business model, it depends on your risk appetite. Right now, most banks are very much in that wait and see kind of place to see how the market develops. There are a lot of ways to get into stable coins. A bank could be an issuer. They could have their own stable coin, they could be a white label issuer. They could work with a white label issuer, so they could have a stable coin that is branded as that bank, but actually managed by someone else. They could just use existing stable coins to send payments to help their customers do payments. They could also hold onto the reserve assets, so they could be the ones who custody those assets or custody stable coins, and they can be a portal for their customers to use stable coins with what's called a wallet. Right now, mostly what they're doing is very little. Only about 6% of community banks have thought about using a stablecoin in any sort of sophisticated way according to a survey by the American banker.

Kyle Thomas (07:27):

Interesting. And so I wonder if some of that reluctance to adopt or slowness is in part one, it's new. So these things take time to work their way into an ecosystem as large as the US financial system, but also that how much of that demand is just being driven or not being driven by the fact that your average consumer, your average household transactions today in a largely digital form, we all have debit cards and credit cards. And so when you go to your coffee shop and you present it for payment, it settles and clears, and we're just used to that technology. So is Stablecoin suffering from a lack of, is it just not breaking through into that market yet? Or are there other impediments that make stable coins maybe cause stablecoin to be having trouble to unseat these incumbent payment systems?

Yevgeny Shrago (08:14):

Yeah, I think that's a great question and your point is totally well taken. Visa says that only about 7 billion of the 1 trillion we saw in stablecoin transactions last year is retail driven. And that's because for most consumers, the current payment systems work, you pay, you tap, you're good.

(08:32):

So this is really right now a business to business use case. And specifically for those businesses that have global cash management needs that are sending money internationally, they're the ones for whom this is something that's interesting. And the other thing to understand is the cost is not as cheap as maybe we put in the hype cycle piece. So yes, it's very cheap to send a stable. The challenge is on the other side, you either need someone to accept that stable coin as payment or you need to turn it into the fiat currency of the country you're sending at, and that costs money. We've talked to banks who have explored this. They're saying that could be like 50 basis points of the money you send. So if you're spending a million dollars, that's $50,000 right there. So it's not necessarily that cheap when you actually get into the technical aspects of it.

Kyle Thomas (09:18):

Sure, a lot of new technology starts out relatively expensive, relatively low volume use cases, but as that technology develops and grows, a lot of times those costs come down, the efficiencies, the scale and stuff all kind of accelerate. So I mean, we saw that with credit card adoption decades ago and maybe we're likely to see that with table coins, maybe we're not. So one of the things that's kind of baked in to the existing and very familiar payment rails and payment systems is or are protections for both the institutions, the merchants and consumers around issues like fraud, cybersecurity, money laundering, et cetera. Can you talk about those things vis-a-vis stable coins? What does the landscape look like for fraud, consumer protection, money laundering, cybersecurity, et cetera?

Yevgeny Shrago (10:06):

Yeah, I think that's a really important question and gets to the heart of the Genius Act, which we'll need to talk about right now. It's pretty unclear and it's pretty limited. Fundamentally, one of the promises of the blockchain is that it's an irreversible payment, so if somebody defrauds you, that money is gone. And of course, it's also another promise of the blockchain is payment

anonymity. That means it's often hard to find that person, even if they have committed fraud, to have law enforcement get the money back. So there's a big risk there. One thing that recently I was talking about is that practice called crypto draining, where someone will offer basically here's a few dollars, whatever, just accept my wallet transaction, but it actually sends this malicious code in that then completely cleans out somebody's wallet, and then they'll go through some mixers, they'll do some different ways to anonymize it and that money can never be found again. Now, there are arguments that have been court cases saying that some of the payment requirements do apply to stable coins to digital asset exchanges. They do have to follow Reg E on all these other requirements, but that's sort of contested and there's not a uniform regulatory framework there right now.

Kyle Thomas (11:18):

Okay, got it. Yeah. So you alluded to in that answer the Genius Act.

Speaker 3 (11:22):

Yeah,

Kyle Thomas (11:22):

And I think now's a good time. We didn't want this episode focused on the Genius Act, and I didn't think it felt right to start there when we didn't really even understand the problem and the size and the scale of what we were talking about. But in July, president Trump signed the guiding and establishing national innovation for us stable coins or what's now commonly known as the Genius Act, and now the agencies and the state regulators are working to promulgate rules and implementation guidance to carry out that law into production. So let's break down the key provisions of the Genius Act. How do you think about it? What do you want our listeners to know? Recognizing that there are a lot of state regulators, community bankers, and state-based financial listeners here.

Yevgeny Shrago (12:00):

So the goal of the Genius Act is to address some of the big problems that have plagued the stablecoin market, creating more confidence in allowing people to adopt some of these issues.

So it requires anyone who wants to issue what's called a payment stable coin in the us, and that's just any stable coin that's redeemable dollar for dollar to register with either a state or a federal regulator and be subject to their licensing and oversight.

Kyle Thomas (12:22):

And that's the issuer,

Yevgeny Shrago (12:23):

That's the issue.

Kyle Thomas (12:23):

The entity minting is the term I hear. That's right. The stable coins.

Yevgeny Shrago (12:28):

That's right. That kind of closes a regulatory gap, which was, it wasn't always, always clear who had sort of federal oversight. The states obviously had oversight in those places, but it creates a federal or state nationwide regulator for those issuers. It bans anyone from marketing or selling payment stable coins that are unlicensed. Everyone has to follow those rules. And then it sets up prudential standards for issuers. So we talked before about tethers reserves. It sets very clearly the reserves have to be dollar for a dollar in asset and it has to be high quality liquid assets, treasuries, cash on deposit, very short-term repos. So it makes it easier that if people do come and ask for their money, they're comfortable that the money is there. It requires capital and liquidity standards again to make sure that the issuer is able to operate and meet its operating requirements. And it sets anti-money laundering. Something we didn't talk about too much, but stable coins are a potentially great tool for money laundering. They have a lot of the characteristics of cash but are even easier to move than cash. And so this requires issuers to have anti-money laundering policies and controls in place to block money if it's used for sanctions avoidance.

Kyle Thomas (13:38):

So a lot of safeguard stuff.

Yevgeny Shrago (13:39):

Yeah, exactly.

Kyle Thomas (13:39):

Both on the Prudential side and on the consumer side potentially, if this is all kind of enacted in the spirit of the law is what we're looking for here. So you've said a couple times here, state and federal, obviously CSPS, that matters a lot to us. What role do states have in the Genius Act? Can you break that down a little bit for us?

Yevgeny Shrago (13:57):

Yeah, I think it's important to start with the fact that, as I said before, states have been regulating digital asset provider service providers and stable coins for up to a decade now.

Kyle Thomas (14:07):

And money movers and money movers for

Yevgeny Shrago (14:09):

Longer than that

Kyle Thomas (14:10):

Money along for a long time, and they've been licensed at the state level for decades.

Yevgeny Shrago (14:13):

And although the Genius Act will preempt this many stable coins right now are treated as stored value under stable money transmission laws. The Genius Act says all previous regulatory regimes are moot if stablecoin has to be regulated under the Genius Act, but states can set up their own regulatory regimes and allow non-bank issuers of stable coins to issue stable coins under that state regime. And the main requirement is that the state regime be substantially similar to the one in the Genius Act. What does substantially similar mean? We're going to maybe have to wait for treasury to tell us a rule, but in our view, and we've sent a comment to treasury laying this out substantially similar means it has all the same prudential and reserving and consumer protection requirements as the ones in the Genius Act, and the state regulator has the authority to enforce those requirements. On top of that, banks can issue stable coins, insured banks can do it through a subsidiary, and that includes a lot of state chartered banks, sort of the core regulatory area of the state bank supervisors. Although the federal regulator of those state chartered banks has the authority to approve it, whether they can issue them, it's still in the authority of the state banking regulator to oversee them for compliance with the Genius Act compliance with state consumer protection law. So they'll continue to be closely involved in the issuance of stable coins.

Kyle Thomas (15:33):

Got it. Okay. So in your discussion there, you were also talking about, or you were kind of teeing this up by talking about the things under genius that non-banks can now do. And one of those things is run payments. I mean that's what this use case is primarily about is payments. So that feels to me like, and this is really a question, I would love your reaction to this, but are we starting to see through genius, the breaking apart of the traditional banking model, the traditional banking model based on taking deposits, lending and payments? Is this peeling off one of those aspects of the banking model and essentially giving it to a group of entities that didn't have it before?

Yevgeny Shrago (16:12):

You're going to get me in trouble here, Kyle. I would say that one, it maybe is less breaking apart and more a continuation of this unbundling that you're talking about. I think that there are certain things that will happen with stable coins that are absolutely going to change the game in payments and allow non-banks to get more into this business. But of course, we already have non-bank money transmitters that do payments under state licenses.

(16:38):

And so I think this is just creating a different avenue csb S'S view that we send in our comment to treasury is that this should only be a tool for digital asset transmission that stablecoin issuers should not be able to use their stablecoin and do the full part of money transmission, basically accept money from a customer, convert it in their own stable coin, move it to someone else's customer and give somebody cash on the other side that's beyond what they should be allowed to do because they're not licensed for it, they're not capitalized for it, they're licensed, capitalized for a very specific activity.

Kyle Thomas (17:16):

So the term narrow is kind of narrow. Exactly right. How we've been phrasing our wishes for this is like keep it narrow. Yes, there's a new competitor on the block doing a piece of what has traditionally been

Speaker 3 (17:26):

Reserved

Kyle Thomas (17:26):

In the banking and money transmission worlds, but this is a pretty, at least so far narrow authorization.

Yevgeny Shrago (17:33):

I expect that in many cases these companies will add a stable coin issuer to their sort of affiliate portfolio of companies, but that they're not going to totally move everything in their money transmission business into a stable coin issuer. And now, by the way, we've heard that and publicly has been said by some state regulators who have money transmitters that we're going to go both and not either or.

Kyle Thomas (17:53):

Right. It's a big ecosystem, and I think for your average US consumer, we move money around and things like Zelle and things like Venmo and don't have a window into the world of the thousands of licensed money transmitters that exist at the state level for various business models and niche markets and what have you. But there are many, many, many of them

Yevgeny Shrago (18:14):

For sure. And I think in many ways that may be that we have just a couple of big stable coins that become sort of the pipes that all of those money transmitters use to move their money through.

Kyle Thomas (18:22):

I wondered about that too because it seems like a key goal in running payments, whether it's domestically or abroad, is to achieve ubiquity that whatever I'm minting and using to transact is universally accepted everywhere else and can just kind of exchange. So it seems like that's a hurdle that these companies are all going to be trying to cross or jump over and we'll see, I guess is the way to do it.

Yevgeny Shrago (18:45):

That's right. The question of where the moat is and who's getting commoditized is one that I think is very much in play over the next few years,

Kyle Thomas (18:52):

But it's taking a very competitive market approach to this. And so I think it's going to go the way of a lot of things that have gone this direction, which is may the best and most efficient win.

Yevgeny Shrago (19:01):

And of course, the existing payment players, they're not sitting still either. PayPal has launched its own stable coin. That's the probably third biggest one right now. Visa and MasterCard are

talking a lot about their stable coin strategies. Stripe has got a big stable coin issuer strategy. So yeah, I think there's a lot to be seen about how this market plays out

Kyle Thomas (19:18):

For sure. So we talked a little bit about the market and the implications it could have on the existing institutions in this market, but I also want to talk about consumers and the consumer protection provisions within genius because consumers are the ultimate bearers and users and holders of this unless it's a kind of a business to business international settlement type transaction. So what did Genius bake in by way of consumer protections?

Yevgeny Shrago (19:42):

So there's a few different things. One, genius is in and of itself a consumer protection statute. By making sure that your stable coin is properly reserved, it means that it's more likely to be there. Two, it puts in protections if the stablecoin does for some reason have a run on it and the stablecoin issue goes bankrupt, the stablecoin reserves are supposed to be tidied. So they're supposed to be sort of a little harder to get at, and they're supposed to have a higher priority in bankruptcy. So if a stablecoin holder should be able to get access to those reserves if the stablecoin issue goes bankrupt, finally, and really important, it preserves federal and state consumer protection law very explicitly says federal consumer protection laws all apply state consumer protection laws except for state licensing and chartering laws are not preempted for either state issuers or in federal issuers. There's been some attempts by the OCC who's the one who will license non-bank federal issuers to say, oh, state laws don't apply to our national banks. They have not always won in court on that. And in my view, it would be both bad policy and bad law for them to say, oh yeah, the Genius Act says the state consumer protection law applies, but actually we know best. We're not going to enforce those laws. We're not going to apply those laws.

Kyle Thomas (21:07):

We have a system today that works

Yevgeny Shrago (21:09):

That

Kyle Thomas (21:09):

Limits preemption in very specific instances. That's

Yevgeny Shrago (21:11):

Right.

Kyle Thomas (21:11):

Otherwise, home, state and state rules apply to the consumer who resides in that state, and that's an important aspect of our financial system.

Yevgeny Shrago (21:18):

That's right. And I think there's actually going to be a lot of interesting legal questions that rise up there when you talk about are they going to operate as payment processes? Okay, well then do they have to comply with F 10 and Reggie? And what does that mean? What does a payment confirmation look like for a stable coin issuer?

Kyle Thomas (21:31):

FTA being electronic funds trans,

Yevgeny Shrago (21:32):

Correct.

Kyle Thomas (21:33):

Sorry. No, no, not at all. So bringing it back into the banking space, you've used the phrase a couple of times now, payment stablecoin issuers. One of the ways you talked about banks being able to get into this game potentially would be to stand up a subsidiary to serve as that issuing entity for payment stable coins. Let's talk a little bit about other options or how could banks who are interested in getting into this game get into it? What's the kind of roadmap for them and recognizing that some of the rules and regulatory approaches here are still in development?

Yevgeny Shrago (22:02):

So I mean, again, the most simple way is to stand up an issuer and apply to whatever their existing federal banking regulator is through that subsidiary to issue stable coins. Another one is to be the custodian. So the reserves, as I said, the reserves have to be custodied. That means they have to be held sort of separately from other funds. They can't be all commingled together except pursuant to very specific legal rules. And so there's limits on who can be the person who holds those stablecoin reserves. Banks are one of the biggest groups that can, and banks have a particular advantage here because banks can treat those custody reserves as what's called cash on deposit so they can use it to fund loans. I think there are some caveats there. Banks will need to think about, okay, is this money really hot? Is it going to run away from us really fast? Is there going to be a concentration limit that the regulators put in to say, okay, you can't have more than 2% of your deposits and stable coin reserves. And then I mean, beyond that, banks can also now hold stable coins that was true before, but now is confirmed and they can custody stablecoin keys. So that's a way to bring in customers, say, give us your stablecoin keys, we'll protect them. We'll make sure that they are safe here. And that

Kyle Thomas (23:10):

Like the old safety deposit box

Yevgeny Shrago (23:11):

Model basically, but the digital version of it. Yeah, that's

Kyle Thomas (23:14):

Right. Interesting. And I ask that question because one of the most frequent points of concern from the banking community, and it's a pretty simple question and it doesn't have always an elegant answer, but the question is essentially, if stable coins really take off and suddenly my current depositors are moving their funds into a wallet, a stable coin wallet, those are dollars that I don't have in my bank to lend and disintermediate and fund local community credit needs, et cetera. One, is that a real concern? I know we talked about this, the on-ramp and the growth of this is TBD and it's growing. But are there responses or structures a bank who's really concerned about that? Or if a bank starts seeing a lot of deposit outflow into these types of wallets, are there responses a bank could take to perhaps protect themselves against that?

Yevgeny Shrago (24:06):

Yeah, I mean, it's a very real concern. So in essence, if people move money from deposits to stable coins, they're moving money from deposits to US treasuries. So instead of lending money to their communities through deposits, they're lending money to the US government that can change the nature of how that money is then invested.

Kyle Thomas (24:26):

It distorts kind of the foundation of our existing financial structure for better or for worse. But it is a distortion

Yevgeny Shrago (24:31):

Perhaps. And then of course when you buy the treasury, you usually don't buy it from the government, you buy it from someone else who then redeposits that cash. But over time, what that's likely to do is redistribute the deposits from community banks who are lending to small businesses, agriculture, rural mortgages to big banks with big money center banks who are using it for more financial applications. And Congress recognized this. And so Congress put in one really important provision, which is that it bars stable coin issuers from paying interest or yield to people who hold stable coins. The idea being a stable coin's, a payment instrument, you buy it, you use it to make your payment, and then you get back into whatever safe asset you hold because of course, stable coins are not insured, unlike deposits.

Kyle Thomas (25:14):

So if stable coins could start to pay interest, or if there are any enterprising stablecoin issuers and collaborations between companies who are finding end runs around this, I'm smiling because I know that there are some talk about this and I want to explore that a little bit more. What existing restrictions are there and how durable are those restrictions?

Yevgeny Shrago (25:34):

Yeah, so there's this ban on paying yield or interest to stablecoin holders by the issuer. And I say by the issuer, it's really important because what a number of companies and issuers have concluded is that this doesn't apply to third parties. It may not even apply to affiliates. So probably most famously Circle has a really close partnership with Coinbase Circle actually pays most of the revenue it earns from the interest on its reserves, which how stablecoin insurers make money to Coinbase and it pays it to Coinbase. Based on the number of USDC coins held at Coinbase, Coinbase has an incentive to get you to hold your US DC at Coinbase. Coinbase uses that incentive offering yield interest like four or 5% I think or more sometimes to people to hold their U US DC at Coinbase. Interesting. So okay, let's just work this out. USC not allowed to pay interest to holders. USDC instead pays all of its money to Coinbase, by the way, that might be paying interest. It's softened, banned. We'll have to work that one out. But USC pays money to Coinbase. Coinbase pays that money to holders. Is that really the issuer not paying interest just by putting an intermediary in?

Kyle Thomas (26:49):

It feels like it is to me, it

Yevgeny Shrago (26:50):

Feels like it is to me too. And maybe even worse example honestly, is PayPal's stablecoin not issued by PayPal issued by a company called Paxos. So branded PayPal, USD, you buy it from PayPal, not from Paxos. And yet if you were to read the Genius Act prohibition narrowly, you would say, okay, but PayPal can pay not the issuer. It seems to be sort of getting around the spirit of the rule.

(27:13):

The federal banking regulators have the authority to make anti evasion rules. CSPS has suggested that this is a really good place to do it, to make it clear that okay, downstream somebody really has no business affiliation. They want to pay some kind of yield. I think some merchants are interested in this to get around interchange. That might be okay, but not if you're a business affiliate of this other company. Separately, there's discussion about doing this in the upcoming market structure regulation. So there's a second bill to regulate digital asset markets, and that's another opportunity. And we've heard some senators express interest in that as well.

Kyle Thomas (27:47):

Yeah, it really seems like something we got to watch out for because that's a key differentiator between the traditional banking model and payment stable coins.

Yevgeny Shrago (27:54):

And so you asked how can banks sort of deal with the deposit flight to stable coins? There's two main areas of interest. One is stablecoin consortium. So remember banks can be issuers. And the FDIC just put out a proposal on how banks can apply to be issuers as through their subsidiaries. And it's specifically noted that a consortium of banks could apply to be an issuer and be treated as essentially a subsidiary of all of those banks. So basically the banks get together, they have one issuer that they own, and then they put the deposits that they get, the money that they get from the stable coins from the purchase of stable coins, they put it as deposits in the banks, so they recapture the deposits.

Kyle Thomas (28:34):

Oh, fascinating.

Yevgeny Shrago (28:35):

Yeah.

Kyle Thomas (28:35):

Okay. So to walk that through, and I'm just going to repeat it to make sure I understand this and make it make sense to me. So a group of banks would get together, maybe they say all community banks in a grand scale, they stand up as stable coin issuing subsidiary. One of those banks stands it up. They start minting stable coins. So the dollars in the consumer economy that are flowing into that payment stablecoin issuer and getting converted into stable coins, those dollars go into the sub, but then get downstreamed into the banks in that network and are then held in typical garden variety deposit accounts against which the institution could lend and maintain a foothold or a hold on those otherwise deposits that would kind of flee the system.

Yevgeny Shrago (29:20):

That's exactly

Kyle Thomas (29:20):

Right. That's fascinating. And so there's groups out there exploring this right now and kind of kicking the tires on this

Yevgeny Shrago (29:25):

Concept? Yeah, there's discussion in a few different groups we've talked to who are interested.

Kyle Thomas (29:29):

It's genius.

Yevgeny Shrago (29:31):

The other option is tokenized deposits. So I think this is a question we get the most, which is like what's the difference between a stable coin and a tokenized deposit?

(29:40):

And the difference is a tokenized deposit. It's a deposit, it sits on a bank's balance sheet, it has deposit insurance, but by tokenizing it, you essentially put an ownership claim on it that can be transferred via the blockchain. So you can get those advantages of stable coins in terms of fast transfer, cheap transfer, but you do it in a form that gets deposit insurance. It's great. Right. The challenge is that it has to live on a bank's balance sheet. A stable coin can be transferred to anyone and is a stable coin. But for a bank to move a tokenized deposit out of its balance sheet, it has to have some kind of relationship with the other banks that other customers use, how they can do that consortium

Kyle Thomas (30:24):

All having access to and sharing that same blockchain.

Yevgeny Shrago (30:27):

Exactly. Right. And so there's a discussion of that and sometimes in parallel of saying, okay, but when we move money between us within tokenized deposits, when we move money outside of our system, we'll use a stable coin and you can easily transfer those things between each other using the blockchain as well.

Kyle Thomas (30:43):

Yeah. Yeah. I wonder how much the average US consumer is going to be able to comprehend all this stuff, or if a lot of what's happening right now is essentially a rewiring and a rerouting of the pipes and the wires that run the US financial system. And if much of that might just be happening behind the scenes, and at the end of the day, we don't really care if my bank is transferring it to somebody else's bank using a tokenized deposit, using a stable coin, they'll figure out which way is most effective, depending on my use case. But when I open my mobile app and see my bank account and want to hit the button to send money, I'll just let the gears, the pipes and the wires behind the scenes handle it for me.

Yevgeny Shrago (31:18):

Yeah, I think that's right. I think most consumers couldn't tell you today what is an A CH versus a wire versus Fed now as a payment method.

Kyle Thomas (31:24):

True.

Yevgeny Shrago (31:24):

I think we'll probably see a similar thing with stable coins and tokenized deposits and whatever other wild payment innovations we might come up with in the future.

Kyle Thomas (31:32):

Yeah. Could be a good episode. Future casting in the payments industry. We

Yevgeny Shrago (31:36):

Can talk about ag agentic AI all day too, and how that ties to stable coins

Kyle Thomas (31:39):

And quantum. Yeah, that's on my list. That's fun. So what's next when it comes to stable coins regulation, in particular, what CSBS kind of advocating for at this moment in time?

Yevgeny Shrago (31:49):

Yeah, Congress set a very ambitious agenda in terms of getting the genius act up and running. And the big thing right now is treasury and the federal banking regulators have a raft of rules due the middle of 2026 to say, basically implement all of the high level requirements around capital liquidity reserves, the state comparability determinations, basically everything that you have a question about they have to answer. So we're going to see, I expect a lot of proposals in the first quarter of 2026 CSBS will be commenting on those to make sure that they continue to respect the role of the state system, respect the difference between issuance and other banking activities, maintain consumer protection. That's going to be, I think, taking up a lot of my time

(32:33):

Along with that as, especially as states start to see those rules unfold. They're going to be thinking, how do we want to put in our stable regulations? What are we going to do? So we'll continue to work with them to share best practices, to share information. And then finally, it's important to talk to the people actually on the ground in the trenches. So we'll be talking to banks, we'll be talking to issuers, money transmitters who are using these to understand what are the use cases, how are they innovating, and what sort of consumer protection is necessary in that world.

Kyle Thomas (33:01):

Yeah, kind of learn as we go.

Yevgeny Shrago (33:02):

Absolutely.

Kyle Thomas (33:02):

Mentality. Well, yeah, this has been very fun. We're very happy to have you at CSPS. Also, very happy to have you on this podcast. Thanks for sharing your genius with us today, and look forward to follow up conversations.

Yevgeny Shrago (33:13):

Thanks for having me, Kyle. Happy to do this anytime.

Kyle Thomas (33:16):

Great.

(33:18):

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