The Daily Dish

Some Clarity on GENIUS?

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Financial services has been a relatively quiet area in recent years but has seen increasing interest with the news that the Senate Banking Committee will hold a January markup of the Digital Asset Market Clarity Act ("Clarity Act"). Clarity is bipartisan legislation that establishes a regulatory framework for digital assets, clarifying jurisdiction between the Securities and Exchange Commission and the Commodity Futures Trading Commission. The bill passed the House of Representatives in July.

One reason for the heightened attention is that it allows Congress to revisit the issue of interest on deposits in stablecoins. Recall that Congress passed, and the president signed into law, the GENIUS Act, which provided a regulatory environment for payment stablecoins. Stablecoins would have to be backed dollar-for-dollar by holdings of Treasuries, so safety of the payment mechanism was assured. It also prohibits stablecoin issuers from directly paying to holders interest, yield, or rewards to keep stablecoin issuers focused on payment mechanisms rather than savings/investment products. That was the straightforward intent of Congress.

There are, however, economically equivalent transactions that the law doesn't explicitly ban. Crypto exchanges, affiliates, or partners can offer yield-like incentives tied to stablecoin holdings. This means issuers can effectively circumvent the ban by having an exchange or third party give rewards that look like interest payments.

How should one think about this?

The incentive to use interest to attract dollars into stablecoin is clear; Congress should have recognized that it was possible to replicate the incentives without using interest *per se*. If the real legislative intent was not simply to ban interest, but to ban all interest-equivalent incentives, then the Clarity Act is an opportunity to get this right in the context of the larger regulatory regime governing crypto.

Or perhaps it was not. In that case, dollars will be attracted away from banks, money market accounts, and other deposits and into stablecoins. This would mean fewer deposits in banks, and the loss – perhaps substantial loss – of the loans the deposits financed. From a purely competitive point of view, it is a negative for the banking sector. Also, while the stablecoins are safe, the individuals face risks that the exchanges themselves could fail. These are negatives for banks and individuals.

On the other hand, the dollars would flow into Treasuries, and some other saver would not have to buy those Treasuries. Instead, their dollars would be available to fund the loans the banks would otherwise make. If the same investment financing happens using a lower-cost transaction mechanism, that is a good thing for the economy as a whole. Overall, the regulatory framework should support competition, innovation, and efficiency.

Viewed from this perspective, the problem with a GENIUS Act-like approach is that it is focused only on stablecoins, providing no way to balance competition between stablecoins and other payment mechanisms. A better approach would have a comprehensive approach to regulation, i.e., a Clarity Act, and seek to put all traditional and digital payments and assets on a level playing field and let the chips fall where they may.

As part and parcel of that, the Clarity Act is an opportunity for Congress to make clear its intent and either remove or codify a loophole that could fundamentally change how we approach traditional banking.