Insight

The GENIUS Act: A Primer

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EXECUTIVE SUMMARY

- The Guiding and Establishing National Innovation for U.S. Stablecoins (GENIUS) Act, signed into law July 18, is a significant step toward a predictable regulatory framework for stablecoin issuers and the first major piece of crypto legislation in the United States.

- The GENIUS Act divvies up regulatory authority for stablecoins and addresses both financial stability and financial crime risks, but legislative ambiguity remains absent agency rulemaking and treatment of the broader cryptocurrency landscape.

- This primer discusses the function of stablecoins, their regulatory history, the GENIUS Act's provisions in this context, and the likely need for future regulation.

INTRODUCTION

After years of regulatory purgatory for the stablecoin industry, Congress passed and the president signed into law the Guiding and Establishing National Innovation for U.S. Stablecoins (GENIUS) Act. The bill is a significant step toward a predictable regulatory framework for stablecoin issuers and the first major piece of crypto legislation in the United States.

The primary accomplishment of the bill is that it sets a framework that provides clarity to stablecoin issuers while addressing financial stability and financial crime risks. The GENIUS Act attempts to meet these goals through the assignment of regulatory authority and establishing systemic risk rules and anti-money laundering rules. But in each of these areas, agency rulemaking will need to fill in the details. And the bill does not address other cryptocurrencies – stablecoins are only 7 percent of the cryptocurrency market.

This primer discusses the function of stablecoins, the regulatory history, the GENIUS Act's provisions in this context, and the likely need for future regulation.

WHAT ARE STABLECOINS?

Stablecoins are a subset of cryptocurrencies that are pegged to a government currency. In the GENIUS Act, "payment stablecoins" are defined in relevant part as a "digital asset […] used as a means of payment or settlement" that the issuer "is obligated to convert, redeem, or repurchase for a fixed amount of monetary value," and for which, the issuer will "create the reasonable expectation that it will maintain, a stable value relative to the value of a fixed amount of monetary value." The two most popular stablecoins, issued by Tether and Circle – which have market capitalizations of $159 billion and $61 billion, respectively, of the total $248 billion stablecoin market – are pegged to the dollar at 1:1.

Stablecoins also have distinct properties from traditional cryptocurrencies. For example, Bitcoin:

- Is decentralized, meaning there is no need to rely on a central bank, commercial bank, or payment provider;
- Has a fixed supply, making it resistant to inflation from government money printing; and
- Has no inherent value as it is not backed by any physical asset or legal claim and its price depends solely on collective belief.

Stablecoins, in contrast, are reliant on an issuer to hold the money backing the coin and vulnerable to inflation of the underlying currency. They can, however, be redeemed for dollars, which reduces their volatility: One stablecoin, Circle, has only traded between $0.9993 and $1.0004 this past year.

Stablecoins currently are primarily used to facilitate crypto trading. Right now, Boston Consulting Group estimates 88 percent of stablecoin transactions are used for crypto trading pairing. Primarily, this entails posting margin for perpetual futures with stablecoins.

In the future, however, stablecoins have the potential to compete with more traditional industries. Citi projects in its bull case that 75 percent of stablecoin market capitalization will derive from competing in the payment, banking, and money market fund industries by 2030. Each of these use cases relies on different features of stablecoins:

- Currently, payments across borders are limited to banking hours and have relatively expensive transaction fees of 1.25–13.65 percent of the total transaction, whereas stablecoins could be faster and cheaper.

- Banking in U.S. dollars in foreign countries is often inconvenient, and stablecoins could provide an alternative when the local currency is undergoing rapid inflation.

- Money market funds and commercial U.S. banks force consumers to trade off yield and ease of transaction, whereas stablecoins could earn high interest similar to money market funds while being as easy to transact with as checking accounts. (Note: This is not possible under the GENIUS Act since yield-bearing stablecoins are excluded.)

Yet the future of stablecoins is highly uncertain. Citi provides a range of 2030 market capitalizations from $540 billion to $3.7 trillion. The result will depend both on industry innovation and regulation.

REGULATORY HISTORY OF STABLECOIN

Initially, regulators gave cryptocurrencies wide leeway. A regulator cited in Harvard Professor Kenneth Rogoff's recent "Our Dollar, Your Problem" described why in 2016: "Right now, cryptocurrencies don't seem to be doing any serious harm, and we don't want to get in the way of all the innovation."

2019 was the turning point, in which Facebook proposed to issue a stablecoin called Libra. With 2 billion users, Libra quickly drew the attention of regulators who feared Facebook might succeed in establishing a global monetary system outside of government control.

This presented a significant problem: It wasn't clear who had authority to regulate cryptocurrencies broadly, and stablecoins in particular. The currency aspects of cryptocurrencies concern the Federal Reserve and Treasury, the commodity aspects of the Commodity Futures Trading Commission (CFTC), and the securities aspects of the Securities and Exchange Commission (SEC). The responsible regulator may even differ depending on the cryptocurrency issuer, with parties ranging from the Fed to the Office of the Comptroller of the Currency, and even the Small Business Administration. The Federal Deposit Insurance Corporation is waiting in the wings if any of these fintechs require bank charters (usually to deny them). Outside of the federal financial services regulators, there are broader privacy and security issues that might concern the National Economic Council or the Financial Stability Oversight Council. Finally, there are numerous state regulators.

During the Biden Administration, the SEC exacerbated the problem. First, it asserted that

all tokens – regardless of their function – were unregistered securities. Then the SEC refused to issue clear rules for registration while launching high-profile enforcement actions against major players such as Coinbase and Ripple. A detailed timeline can be found here. Firms faced the impossible choice of risking litigation or attempting to comply with a regime that, in practice, didn't exist. It was regulation by lawsuit.

THE GENIUS ACT

The GENIUS Act does three key things:

- It divvies up regulatory authority among the various agencies and encourages prompt rulemaking.
- It carries over many requirements from post-2008 banking regulation – alongside a few new innovations – for reducing systemic risk.
- It gives broad authority to the Treasury secretary to promulgate anti-money laundering rules analogous to those in the Bank Secrecy Act.

THE NEW REGULATORY AUTHORITIES

The GENIUS Act has a three-tiered structure for regulatory authority. The STABLE Act of 2020 had a single tier; all stablecoin issuers were to obtain a banking charter and be regulated under the Federal Deposit Insurance Corporation. The TRUST Act of 2022 and Clarity of Payment Stablecoins Act of 2023 added a second tier, allowing for issuers regulated by state banking authorities. The GENIUS Act adds a third tier that allows federal nonbank issuers to be regulated by the Office of the Comptroller of the Currency. This scheme will allow for more competition. Indiana University Professor Vivian Fang explains that the "tiered approach has been welcomed by an industry that has organically grown outside the traditional banking system—led by private issuers who were never banks and have shown little interest in becoming them."

The GENIUS Act also pushes regulators to promulgate rules promptly, which will prevent regulation by lawsuit. While there is no unified deadline for when regulators must finish final rulemaking, the Act sets specific timeframes for key actions – such as certification reviews and transition thresholds – that create structured pressure to act. This approach may not guarantee timely implementation, but it encourages regulatory clarity instead of case-by-case applications of non-specific rules in lawsuits.

It remains to be seen if this regulatory design works in practice, however. Regulator

responses to the Dodd-Frank Act of 2010 may be instructive: Many major rules took years to finalize and 45 percent of rulemaking deadlines were missed. Moreover, since stablecoin regulation is highly analogous to banking regulation, moving authority out of the SEC and CFTC and into non-bank regulators might lead to unforeseen problems. A group of law professors have raised concerns about the Stablecoin Certification Review Committee, in particular.

SYSTEMIC RISK

Stablecoins also pose systemic risks, risks where failure in one part of a system can cause a broader crisis. In particular, stablecoin issuers will likely become large investors in treasuries, so if a large issuer such as Circle faces a crisis – as in the 2023 Silicon Valley Bank collapse – it might be forced to sell off its treasuries in panic, resulting in broader damage and loss of confidence to the financial system.

The GENIUS Act includes many provisions intended to mitigate systemic risks. Two are similar to regulations from Dodd-Frank. First, capital requirements will require stablecoin issuers to hold equity that serves as a buffer in the case of a crisis. The result is that if an issuer loses money on its investments, its shareholders take loss first, which limits damage to the rest of the system. Second, reserve requirements mean issuers can only invest in short-term treasuries and bank deposits, making it less likely issuers face a crisis in the first place.

Two further regulations are more novel. First, a non-financial company "may not issue a payment stablecoin unless" it "obtains a unanimous vote of the Stablecoin Certification Review Committee finding," among other requirements that "it will not pose a material risk to the safety and soundness of the United States banking system." This provision aims to separate damage to the financial side of a large company from spreading to its non-financial functions. The provision also reduces competition from companies like Walmart, Amazon, and Facebook, however, which might raise systemic risk by increasing concentration within the stablecoin industry. Second, by excluding yield-bearing stablecoins, the Act limits the spread of stablecoins into the banking industry. This lowers the chances of a severe financial crisis but also substantially raises the costs in terms of foregone interest of stablecoins.

ANTI-MONEY LAUNDERING

Anti-money laundering (AML) rules, which encompasses know-your-customer (KYC) and countering the financing of terrorism (CFT) regulations has been a core part of US banking regulation since the passage of the Bank Secrecy Act (BSA) in 1970. The purpose of AML is

to prevent financial institutions from being used to conceal illicit funds. Its historical roots are in combating organized crime, but addressing terrorist financing and global threats such as sanctions evasion and cybercrime have become important in the 21st century.

The GENIUS Act gives regulators substantial discretion to design rules that are both analogous to traditional banking regulation but also work with blockchain technology. The key provisions are:

The primary Federal payment stablecoin regulators shall […] issue regulations implementing […] appropriate operational, compliance, and information technology risk management principles-based requirements and standards, including Bank Secrecy Act and sanctions compliance standards, that—(I) are tailored to the business model and risk profile of permitted payment stablecoin issuers; and (II) are consistent with applicable law.

And:

Beginning on the date that is 30 days after the date of enactment of this Act, and for a period of 60 days thereafter, the Secretary of the Treasury shall seek public comment to identify innovative or novel methods, techniques, or strategies that regulated financial institutions use, or have the potential to use, to detect illicit activity, such as money laundering, involving digital assets, including comments with respect to— (1) application program interfaces; (2) artificial intelligence; (3) digital identify (sic) verification; and (4) use of blockchain technology and monitoring.

This represents a substantial delegation to regulators but provides both a starting point – the BSA – and some guidance for where compliance might be tightened or loosened.

This approach is sensible because there has been substantial innovation in AML compliance within the stablecoin industry. Take the Travel Rule, a key part of AML regulation in traditional banking that requires payment providers to collect info on senders and receivers so that personal identifying information travels with a transaction as it moves between financial institutions. Currently, because of the prevalence of non-custodial wallets that do not collect identifying information, one estimate finds this rule would be hard to enforce on more than 20 percent of transactions. Yet regulators might be able to require smart contracts or usage of centralized exchanges to solve this problem. Determining costs and benefits between different compliance schemes requires detailed technical knowledge of fast-evolving conditions, so delegation to regulators is appropriate.

THE FUTURE OF CRYPTO REGULATION

Future legislation will need to track stablecoin usage as well as future technological

innovations. As stablecoin usage grows and the risks and benefits are better understood, it's important that the GENIUS Act undergo frequent updates. If new risks surface, Congress should not leave regulators to stretch existing authority. And if old regulations are shown to be superfluous, Congress should remove them.

Congress will also need to make decisions on regulating other digital assets. Stablecoins represent less than 7 percent of the crypto market. Therefore, the GENIUS Act leaves the other 93 percent of the market in regulatory limbo. Furthermore, Congress should provide guidance to the Fed regarding Central Bank Digital Currencies. The Digital Asset Market Clarity Act and the Anti-CBDC Surveillance State Act passed alongside the GENIUS Act in the House – but not yet passed in the Senate – would address these issues.

CONCLUSION

The GENIUS Act provides a strong framework for stablecoins and clarifies the rules for issuers while still allowing for increased competition. But the final impacts of this de novo legislation are still highly uncertain, and much will depend on how regulators collaborate to interpret and implement the new rules. More broadly, stablecoins represent one of the smallest and simplest elements of the wider crypto ecosystem, indicating a tough battle ahead for market structure and other congressional crypto priorities.