The Stablecoins Debate

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In 1982 E. Gerald Corrigan, then president of the Federal Reserve Bank of Minneapolis, asked "Are Banks Special?"[1] He did so at the behest of Paul Volcker when Volcker was chairman of the Federal Reserve Board and at a time when there was "rapid change, with market innovation and new sources of competition" to banks from nonbanks and the "perception that banks' competitive position—and presumably their market share—has slipped".[2] Corrigan's paper provided an approach to think about the future scope of banking activities and bank structure that, in hindsight, appears to have predicted largely how banking law would evolve for at least the next 20 years after his writing.[3]

At a time when we once again see a rapid pace of innovation in the financial sector and banks are facing increased competition from new nonbank innovators, we thought it appropriate to turn back to Corrigan's perceptive and influential work to see what lessons it can offer. As described below, his analysis provides yet another lens through which to view the stablecoin debate. Moreover, his struggles with how to consider money market mutual funds ("MMFs") helps inform the debate, given not only that MMFs and stablecoins have similarities, but also that MMFs were, at the time of the essay (as stablecoins are now), relatively small, new and novel financial products.

Relevance of Corrigan's Framework

Corrigan's article begins by arguing that banks are special because they perform three essential functions: (1) banks offer transaction accounts; (2) banks are the backup source of liquidity for all other institutions; and (3) banks are the transmission belt for monetary policy. In 2000, Corrigan offered a "Revisitation" of his original analysis and concluded that there remained a "core validity" to these traits.[4]

Based on this analysis, the article seeks to provide a definition of bank "that is both functionally and intellectually satisfactory" by identifying the essential function or functions of a bank. Corrigan then asserts that institutions meeting this definition should receive the privileges and obligations

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[1] E. Gerald Corrigan, *Are Banks Special?*, The Federal Reserve Bank of Minneapolis 1982 Annual Report, available here [hereinafter, the "1982 Paper"].

[2] 1982 Paper at 5.

[3] *See, e.g.*, H. Rodgin Cohen, *Are Banks Special? A Re-Revisitation*, Banking Perspectives (2017), available here.

[4] E. Gerald Corrigan, *Are Banks Special? A Revisitation*, The Federal Reserve Bank of Minneapolis (2000), available here [hereinafter, the "2000 Revisitation"].

associated with the status, such as access to the federal safety net and a heightened degree of fully consolidated prudential supervision.

At the outset, it is important to acknowledge that Corrigan's almost four-decade-old paper does not perfectly fit stablecoin issuers, mostly notably because stablecoin issuers may not possess all the features that Corrigan believed made banks special in 1982 (particularly the latter two). At the same time, today, traditional banks may not possess those latter two attributes to the same degree as they did in 1982.[5] Nevertheless, as described below, the heart of Corrigan's analysis appears to continue to provide a useful lens through which the stablecoin issues that policymakers are considering today can be analyzed.

The Core Characteristic

Corrigan wrote that "the single characteristic of banks that distinguishes them from other classes of institutions is that they issue transaction accounts".[6] Accordingly, Corrigan said that a bank should be defined as any organization that is *eligible* to issue transaction accounts. [7] Corrigan defined transaction accounts to be accounts that (1) in law, in regulation or *in practice* are payable on demand at par and (2) are readily transferable to third parties.[8]

When the key features of stablecoins are measured against Corrigan's definition of a bank, the answer also appears to be "yes, stablecoins are special". In other words, stablecoins appear to meet Corrigan's definition of bank. For example, although there is not a uniform structural design or legal construct for a stablecoin arrangement, observers have noted that in a "true stablecoin" the issuer "agrees to mint and buy back coins at par".[9] Moreover, stablecoins are intended to be readily transferable to third parties.[10] Thus, it would appear that both elements of a transaction account under Corrigan's bank definition are satisfied.

Corrigan's MMF Analysis

As many commenters have noted, stablecoins and MMFs are quite similar.[11] Therefore, it might be surprising that Corrigan concluded that MMFs should *not* be considered banks under his definition. Corrigan arrived at this conclusion because it was not clear to him that an MMF

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[5] For example, one academic found in 2018 that "over time, banks have become less special" in large part due to the expansion of monetary policy beyond banks, the creation of more robust payment systems, and the availability of central banks' emergency lending to nonbanks. Thomas Huertas, *Are Banks Still Special?*, Journal of Financial Perspectives, Vol. 5, No. 1 (2018), available here. In contrast, the offering of transaction accounts continues to be a core bank function and arguably the most important. Given that eligibility to issue transaction accounts is the sole criterion for the definition of bank that Corrigan offered, he may have believed when writing the article that it was the most important of the three essential functions he offered.

[6] 1982 Paper at 13.

[7] *Id.* (emphasis in original).

[8] *Id*. (emphasis added). Contemporary academics generally appear to agree that a distinguishing characteristic of a bank is that deposit-taking function. *See* Brief for Thirty-Three Banking Law Scholars as Amicus Curiae, Lacewell v. Office of the Comptroller of the Currency, 999 F.3d 130 (2021), available here. In fact, academics have similarly focused on deposit taking when analyzing stablecoins. *See, e.g.*, Gary B. Gorton and Jeffery Zhang, *Taming Wildcat Stablecoins* (2021), available here; Howell E. Jackson and Morgan Ricks, *Locating Stablecoins within the Regulatory Perimeter* (2021), available here. Others have focused on transforming such shorter-term obligations into longer-term assets like commercial paper. *See* Bill Nelson, *Liquidity Transformation Always Finds That Path of Least Regulation* (Sept. 23, 2021), available here.

[9] Christian Catalini and Jai Massari, *Stablecoins and the Future of Money*, Harvard Business Review (2021), available here.

[10] *Id*.

[11] Gorton and Zhang, *supra* note 8.

account is payable on demand at par or readily transferable to third parties. Specifically, he reasoned that an MMF's "ability to pay out dollar-for-dollar the amount of the initial 'deposit' is less certain" than it is for traditional banks because MMFs do not have capital and do not have access to easy sources of liquidity or deposit insurance.[12] Corrigan also noted that MMFs required access to the banking system "at some point" (presumably, for example, to convert an MMF interest to an interest that is "readily transferable to third parties").[13]

It is worth observing that the features that Corrigan noted as undermining the conclusion that MMFs are payable on demand at par are attributes of the regulatory framework applicable to MMFs, not inherent to MMFs as institutions or products. That is, if MMFs were subject to bank-style regulation, they would be subject to capital requirements, have access to easy liquidity (the discount window) and offer the protection of deposit insurance. Said differently, the antecedent and consequent of Corrigan's framework seem to be switched when he discusses MMFs.

In fairness, Corrigan appeared genuinely conflicted about how to treat MMFs, noting that the "features of some funds simply may create too much of a 'look alike' situation to make a meaningful distinction on the technical grounds of payment at par".[14] In addition, as is well known, in 2008 and 2020, the government took actions to provide MMFs with government support, including temporarily instating what was effectively a version of deposit insurance for MMFs in 2008.[15] It would appear that those actions suggest there was a conclusion from policymakers at those times that MMFs were also "special" and that the technical distinctions described in Corrigan's paper did not hold up under severe market dislocations—that is, MMFs needed to be provided with support similar to that available to banks.

Comparison of MMFs to Stablecoins

As with MMFs, stablecoin issuers today are nonbanks that are not subject to capital requirements and do not necessarily have access to easy sources of liquidity or deposit insurance. However, unlike an MMF share, a stablecoin can be more readily transferred directly to a third party and, in the current digital asset ecosystem, can be used to transact directly for a wide range of goods and services without accessing the banking system. It remains true that "at some point" it may be necessary to use a transaction account at a bank to dispose of or acquire a stablecoin, but that point appears much less frequently than in the case of MMFs because stablecoins may be often used to purchase other digital assets and can be used to acquire goods and services.

Given the somewhat blurry relationship Corrigan establishes between transaction accounts and their unique need for government support, along with the U.S. government's subsequent support of MMFs notwithstanding their nonbank status, the conclusion to be drawn may be that accounts that "look like" they are redeemable at par and readily transferable to a third party (and stablecoins appear more readily transferable than MMF interests) will always be susceptible to

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[12] 1982 Paper at 15.
[13] 1982 Paper at 8.
[14] 1982 Paper at 15.
[15] During the 2008 global financial crisis, the U.S. government took various measures to support MMFs, including the establishment of the Temporary Guarantee Program for MMFs and various liquidity facilities, such as: the Commercial Paper Funding Facility, the Asset Backed Commercial Paper Money Market Mutual Fund Liquidity Facility and the Money Market Investor Funding Facility. More recently, in March 2020, the Federal Reserve established the Money Market Mutual Fund Liquidity Facility to support MMFs during the market stresses related to the onset of the COVID-19 pandemic.

runs and will require government support either before they pose a risk to financial stability or when they do so (which, with scale, seems inevitably to be the case). As to which one it should be, Corrigan concludes his 2000 Revisitation by emphasizing the policy goal of moving away from reliance on *de facto* official intervention.[16]

Lessons for Regulatory Approaches

Finding that stablecoin issuers are special would not necessarily mean that stablecoin issuers should be regarded as banks as a legal matter. This finding also would not necessarily mean that the same full suite of prudential regulation that is appropriate for banks would be appropriate for stablecoins, as (1) Corrigan's assumptions about a bank's role in monetary policy and as liquidity providers may not be as applicable to stablecoins and (2) Corrigan (understandably) did not explicitly consider the financial stability risks associated with offering functional deposit accounts without significant prudential regulation.

Corrigan's analysis, however, offers lessons for the regulatory approaches that should be considered for any firm that is "special" in the same way as banks are. The main lesson appears to be that where in practice the market views a product as payable on demand at par, technical distinctions regarding what constitutes a transaction account may not matter and some type of prudential regulation may always be necessary (as compared to, for example, investor protection or disclosure-style regulation) if policymakers wish to minimize the risk of needing to provide government support to stablecoin issuers in a crisis. A notable example of this line of thinking is the recommendation in the President's Working Group 2010 report regarding MMF reform that bank-like regulation be introduced for MMFs.[17]

Corrigan's original essay was prepared at a time when regulators and industry participants were in debate about the powers and structure of banking organizations. Thus, once he determined banks are "special" and sought to define them, he then asked what kinds of powers should banks and their affiliates have, what controls should be placed on the ownership of banks and how banking organizations should be structured.[18] Accordingly, Corrigan's essays provide a framework for useful questions to consider in the current debate about the regulation of stablecoins. To name just a few: Should the government ensure that stablecoin issuers can meet the "practice" of being payable on demand at par? If not, how may the government avoid resultant risks to U.S. financial stability? If so, what package of government protections and prudential regulation is appropriate? For example, what kinds of activities should be permissible for stablecoin issuers and their affiliates? What types of entities should be permitted to own or control stablecoin issuers?

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[16] 2000 Revisitation.

[17] "Functional similarities between MMF shares and deposits, as well as the risk of runs on both types of instruments, provide a rationale for introducing bank-like regulation for MMFs. For example, mandating that stable NAV MMFs be reorganized as [special purpose banks] might subject these MMFs to banking oversight and regulation, including requirements for reserves and capital buffers, and provide MMFs with access to a liquidity backstop and insurance coverage within a regulatory framework specifically designed for mitigation of systemic risk". Report of the President's Working Group on Financial Markets: Money Market Fund Reform Options (Oct. 2010) (citing Group of Thirty, Financial Reform: A Framework for Financial Stability (Jan. 15, 2009)), available here.

[18] For institutions that are banks under the existing legal framework, those questions have been resolved, most notably by the Gramm-Leach-Bliley Act of 1999, a point Corrigan notes in his 2000 Revisitation.

Are capital requirements necessary? All of these subjects merit further analysis and consideration.

Conclusion

Corrigan's essays from 1982 and 2000 provide a useful analytical framework for considering the current policy debate about stablecoins. The framework is particularly useful in terms of (1) recognizing that the lack of a regulatory framework for capital standards or access to liquidity should not be seen as an indication that a product is not regarded in practice as a transaction account, as the experience of MMFs have proven and (2) outlining the types of regulatory tools (*e.g.*, prudential regulation) that may be useful to ensure that an institution, such as a stablecoin issuer, that offers accounts that (at the very least) look like transaction accounts, are capable of continuing to provide consumers and businesses with the functions that make them so special in the first place.