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The Honorable French Hill
Chairman
Subcommittee on Digital Assets, Financial Technology, and Inclusion
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

The Honorable Stephen Lynch
Ranking Member
Subcommittee on Digital Assets, Financial Technology, and Inclusion
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Dear Chairman Hill and Ranking Member Lynch,

On behalf of America's credit unions, I am writing regarding your hearing entitled, "The Future of Digital Assets: Identifying the Regulatory Gaps in Digital Asset Market Structure." CUNA represents America's credit unions and their more than 135 million members.

The significant impact of digital assets on the financial sector and the overall economy cannot be denied. In November of 2021, the cryptocurrency market exceeded a $3 trillion market cap, and the extreme price volatility of Bitcoin and Ether has sent shockwaves across the economy. The International Monetary Fund (IMF) has established correlation between cryptocurrencies and major stock indices and their analysis has shown that "spillovers between crypto and equity markets tend to increase in episodes of financial market volatility."[1] Additionally, this correlation could pose a significant risk to financial stability as the United States sees increased adoption of cryptocurrencies.[2]

Surveys have shown that around 16% of adults in the United States are engaged with cryptocurrencies.[3] 2022 data showed that number more than doubles to 39% when surveying credit union members as a whole and increases to 59% when evaluating credit union members between 18 and 34 years of age.[4] Despite the crypto winter triggered by last years' failures, this years' survey maintained above average involvement in cryptocurrencies by credit union members—22% of credit union members are still engaged with cryptocurrencies with 42% of credit union members between 18-34 years of age.[5]

The failure of FTX, and the numerous other digital asset companies over the last year, has made crystal clear the need for a comprehensive regulatory framework to govern the digital assets system. The threat to consumer welfare has been demonstrated time and again by the misrepresentation and false statements presented to consumers regarding the state of their funds, the reserves held by exchanges and lenders, and the insurance status of the companies. Congress and federal regulators must ensure these companies are held to account and are no longer allowed to take advantage of consumers and the lax regulatory environment in which they are currently operating.

Blockchain was introduced in 2008 to be used as the public ledger for Bitcoin, and the first Bitcoin was mined in 2009. Since then, blockchain has expanded beyond digital currency as the novel technology can be used for everything from copyright and royalty protection to real estate and land transfers. This technology is still in its nascent state, and it has the possibility to completely transform industries, but we see no reason why innovation should change the government's role in overseeing an industry that uses blockchain. In fact, there is tremendous innovation currently happening in the credit union space surrounding use cases for blockchain and distributed ledger technology as a result of the National Credit Union Administration's (NCUA) letters to credit unions encouraging innovation because of the significant benefits the technology can provide to members. These letters related to digital assets include:

1. In December 2021, the NCUA issued a letter stating that credit unions can "establish relationships with third-party providers that offer digital assets services to the FICU's members, provided certain conditions are met."
2. In May 2022, the NCUA told credit unions they could use distributed ledger technology (DLT) for business uses to enhance their operations and ongoing competitiveness.

Credit unions support appropriate oversight and regulation of the digital assets marketplace to prevent regulatory arbitrage by largely unregulated financial technology companies (fintechs) and other unregulated entities provided financial services to consumers. The industry needs a comprehensive national standard that levels the playing field and protects consumers and the financial system.

This is why credit unions support the "whole-of-government" approach to regulation outlined in President Biden's Executive Order to ensure appropriate oversight and regulation of the marketplace and to prevent regulatory arbitrage by fintechs and other unregulated entities providing financial services to consumers. The development of a comprehensive national standard will level the playing field, protect consumers and the financial system, and promote the policy objectives contained in the Executive Order:

(a) Protection of consumers, investors, and businesses in the United States;
(b) Protection of United States and global financial stability and the mitigation of systemic risk;
(c) Mitigation of illicit finance and national security risks posed by misuse of digital assets;
(d) Reinforcement of U.S. leadership in the global financial system and in technological and economic competitiveness, including through the responsible development of payment innovations and digital assets;
(e) Promotion of access to safe and affordable financial services; and
(f) Support of technological advances that promote responsible development and use of digital assets.

Regulation of the crypto industry must be commensurate with the innovation and development occurring, or these systemic failures will persist and infect the larger economic ecosystem. Regulated financial institutions, like credit unions, must have the required authorities to fully engage in the cryptocurrency marketplace—starting with the ability to custody crypto-assets. Credit union members trust their credit union to provide necessary financial services, and the ability to provide new financial services products and delivery channels is needed for credit unions to fulfill their mission. Moreover, credit unions' focus on financial literacy and financial education can be extended to crypto-related products in order to help members use these new products prudently. Innovation cannot be effective if it leaves a significant portion of the market behind.

The cryptocurrency boom of 2021 drove consumers to the product in hopes of profiting from the gold rush. Crypto exchanges, like FTX, marketed themselves as easy-to-use platforms for crypto novices to buy, sell, and hold crypto assets. These companies were insufficiently regulated and as the market ebbed and flowed, they encountered liquidity crises and were unable to fulfill customer orders. As a result, these exchanges halted sales and withdrawals—leaving consumers unable to access their funds or coins and most likely left holding the bag. Consumers must be granted a safe, secure, and trusted option through which to engage with this nascent industry—that option is their credit union.

As you know, our member credit unions are highly regulated in their operation and credit union members are protected by a plethora of consumer protection laws. The crypto and digital currency sectors operate largely outside of the traditional financial safeguards and generally without financial intermediaries where the role of stabilizer and protector typically rest. In fact, like fintechs, once one wades through the novel technology, the fundamental innovation of cryptocurrency is the elimination of the financial intermediary. Unfortunately, when there is no financial intermediary, the functions that they provide are also lost.

Treasury Secretary Yellen reinforced this point in the recently when she stated, "[w]hile non-bank firms' entrance into core consumer finance markets has increased competition and innovation, it has not come without additional risks to consumer protection and market integrity." The comprehensive regulatory framework and accompanying strict oversight and examination to which credit unions and banks are subject has a proven track record of protecting consumers and ensuring safe and sound operations. This framework also ensures that innovations in the industry are given thoughtful consideration and measured implementation to protect consumers and the financial system from unidentified risks.

Credit unions are concerned that digital assets expand some providers' ability to offer products and services outside the scope of regulations, and the ease at which they can be used to facilitate criminal activity. Whether from a fintech engaging in regulatory arbitrage or the avoidance of regulation through disintermediation of financial institutions enabled by cryptocurrencies and other digital assets, consumers receive less protection when bank-like services such as deposit taking, lending, and payments are obtained outside of the regulated banking system. We are less concerned with the novel technology used to offer these services than we are with the culture created by fintechs and users of digital currency to avoid regulation of products and services that evolve to look like traditional banking services with none of the protection offered by regulated banks and credit unions.

The business model of "regulatory arbitrage" generally leverages technology and sometimes the misuse of banking charters to skirt laws and regulations designed to protect consumers. Tasked with safeguarding consumers' money, credit unions and banks are generally regarded to be the most regulated part of the financial system. Because this regulation comes with a cost, entities looking to provide bank like services without regulation can leverage technology to drive down cost and speed up innovation without considering risk or the negative impact of their actions.

Crypto service providers have taken full advantage of this regulatory work-around. The answer must be a comprehensive framework that ensures these companies are subject to regulations, examinations, and oversight commensurate with the services they are providing. This should include, at a minimum, stringent capital and liquidity requirements, a strong proof-of-reserves system, concentration caps, safety and soundness parameters, comprehensive data security and privacy regulations, consistent oversight and examinations. This approach should be coordinated among the prudential regulators to provide clarity, a level playing field that encourages competition, appropriate consumer protections, and responsible innovation. Furthermore, there should be parity among all depository institutions as to their powers and authorities in the crypto assets space and the regulations, or lack thereof, should not disadvantage them to less regulated fintechs and other new market entrants. Regulatory guiderails will allow credit unions to confidently engage with digital assets and provide a trusted entry point for a novel product to their members.

Any digital assets regulatory framework must continue to value privacy of the consumer while complying with applicable Anti-Money Laundering (AML), Combating the Financing of Terrorism (CFT), and Know Your Customer (KYC) obligations. Financial institutions currently adopt and operate under a strict cybersecurity regime imposed by the Gramm-Leach Bliley Act (GLBA), and consumers trust their data is secure at their credit union or bank due to these stringent standards. Additionally, the blockchain is built on tenants of privacy in transactions. Conversely, the retail sector has no such requirements, and the financial institution bears the burden of breaches that occur. Integrating the digital assets marketplace into traditional financial services requires that the same privacy and security obligations are extended to nonbank fintechs and new market entrants. A digital assets framework must also bring nonbank fintechs engaging in equivalent activities under the purview of the Financial Crimes Enforcement Network (FinCEN) to ensure they are actively working to combat financial crime as well as the Consumer Financial Protection Bureau (CFPB) to ensure consumers are protected.

On behalf of America's credit unions and their more than 135 million members, thank you for holding this hearing and considering our views.

Sincerely,

Jim Nussle
President & CEO