Closing the Payment of Interest Loophole for Stablecoins

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As policymakers consider digital asset market structure legislation, it is important that the requirements in the GENIUS Act, now signed into law, prohibiting the payment of interest and yield on stablecoins are not evaded or undermined.

Background

Payment stablecoins do not substitute for bank deposits, money market funds or investment products, and payment stablecoin issuers are not regulated, supervised or examined in the same way. These distinctions are why payment stablecoins should not pay interest the way highly regulated and supervised banks do on deposits or offer yield as money market funds do.

- Bank deposits are an important source of funding for banks to make loans, and money market funds are securities that make investments and subsequently offer yield. Payment stablecoins serve a different purpose, as they neither fund loans nor are regulated as securities.

Flight risk and opportunity cost

The Treasury Department issued a report in April estimating that stablecoins could lead to as much as $6.6 trillion in deposit outflows, depending on whether stablecoins are able to offer interest or yield. With affiliates of stablecoin issuers or exchanges still being able to pay interest on stablecoins, the risk of significant deposit flight is even greater.

- **Why it matters:** Banks power the economy by turning deposits into loans. Incentivizing a shift from bank deposits and money market funds to stablecoins would end up increasing lending costs and reducing loans to businesses and consumer households.

Potential for evasion

The GENIUS Act contained a prohibition on stablecoin issuers offering interest or yield, as well as other financial and non-financial rewards, to holders of stablecoins. However, without an explicit prohibition applying to exchanges, which act as a distribution channel for stablecoin issuers or business affiliates, the requirements in the GENIUS Act can be easily evaded and undermined by allowing payment of interest indirectly to holders of stablecoins.

These arrangements between stablecoin issuers and affiliates or exchanges, often jointly and explicitly marketed to consumers, will undermine the GENIUS Act's prohibition regarding payment of interest and yield. The result will be greater deposit flight risk, especially in times of stress, that will undermine credit creation throughout the economy. The corresponding reduction in credit supply means higher interest rates, fewer loans, and increased costs for Main Street businesses and households.

Bottom line: Congress must protect the flow of credit to American businesses and families and the stability of the most important financial market by closing the stablecoin payment of interest loophole.