Anna Gelpern:

This might be the first time we have two lawyers or two people trained as lawyers on the stage. So particularly delighted.

Michael Barr:

We'll be very careful.

Anna Gelpern:

So Michael, thank you so much. You've given us an enormous amount to think about and I've been getting questions from my students all along. So I suspect that this has stimulated a lot of thinking along the way. I wanted to start with a big-ish picture question that does come from one of my students and that is, "Would it be fair to think of this period as analogous to crypto's Dodd-Frank moment?" Or sort of have the recent events that certainly inform your remarks clarified the path forward, not just for you and your colleagues, but more broadly and you should know about Dodd-Frank having played rather an active role in that as you suggested.

Michael Barr:

I do think this is a really critical moment for us and for the public and for Congress to take a step back and look at the risks and benefits of crypto asset related activity broadly. We have just gone through an experience that did not cause enormous disruption to our broader economy, but was quite disruptive to the crypto asset sector and in a way that revealed some of the problems that people had been highlighting about the sector for a long time like the lack of transparency, the fact that many entities engaged in this activity actively sought to avoid being supervised or regulated, the problem of fraud, misuse of customer funds, some of the hype associated with stablecoins and with crypto asset activities more broadly sort of revealed.

So it's an appropriate time to step back and look at those risks. And then I do think we need to come in and establish an appropriate framework for regulating that activity. We're focused at the Federal Reserve and with my sister banking agencies [inaudible 00:02:34] using our existing authorities with respect to the safety and soundness and compliance of the banking system.

But obviously there's a set of activity going on that is mostly not in the banking sector, is mostly outside the banking sector and other market regulators in Congress need to think about the appropriate role for regulation of those entities. And as I mentioned at the end of my remarks, I think there's a critical role for Congress to play right now in establishing a framework for stablecoins because stablecoins in particular pose the potential for systemic risk if they're not regulated appropriately if we don't have strong federal prudential supervision and oversight of stablecoins. They do have this ability because of network effects to scale quickly. And they are a form of private money that borrows the trust of the central bank. And I think that's absolutely critical that we get the regulatory oversight of that right.

Anna Gelpern:

So yet again, this gives rise to a whole bunch of fascinating questions, I'm sure, for our audience, but also for me. You mentioned the financial stability risk, particularly from stablecoins and kind of the world that we both occupied on occasion. I'm reminded on the one hand of money market funds on the other hand of currency boards. And so there are a few ways to think about this. You can draw regulatory perimeters and say, "Look, we're going to oversee everything inside and we feel okay about what's happening outside." Either because somebody else is taking care of it or because it's not worrisome.

But then there is... And I would love for you to elaborate a little bit on perimeter drawing in this space, not just... Absolutely for stablecoins, but also beyond that and sort of the grammatical uncertainty of what crypto might. Is it an adjective or is it a noun? I think it stands for a deeper classification problem, honestly. But then there's another dimension and we might follow up on that, and that is both you and Jay Powell characterized stablecoins as private money. Well, one way to deal with private money is public money. So kind of your position on public digital currency in the US and beyond I think would be really interesting to tease out in relation to the concerns about stablecoins.

Michael Barr:

Well, let me try and I think we've got maybe three categories of questions. In the first category, it's really a question about what's inside and outside the regulatory perimeter. And as you and your students know because you're in the middle of this now, that is a pervasive question in banking regulation and has been throughout our history. And there's always going to be some set of activities that happen outside of whatever line you draw. And then the question is, "How comfortable do you feel about that activity being outside the perimeter and how should it be regulated if it's not?"

My view is not everything has to be in the banking system. It's fine for there to be market activities that occur outside of banks, outside of prudential supervision. We still need for those kinds of activities, strong rules of the road. One of the reasons that we have the most effective and innovative and efficient capital markets in the world is because we have really good strict laws that enforce investor protection, that enforce transparency, that enforce segregation of client assets, that have rules about what kinds of entity can do what functions that separate functions where there might be serious conflicts of interest. And so those rules have created, I think one of the most vibrant and efficient markets in the world.

The crypto sector is trying to operate without those rules. And I think that that's a significant risk with respect to stablecoins, in addition to the kinds of market risk that I described, there's a serious prudential risk, which is that you have an unregulated form of private money that then gains traction because of network effects. And then once people are used to using it collapses because it doesn't have the appropriate controls. And if you think about various periods in our US history, if you think about the period before the Comptroller of the Currencies Office was established and before National Bank notes were issued in the Civil War, we had lots of private money, private bank notes were used, we had institutions offering individual notes that people then had to go negotiate with each other about what they were really worth. Is it really worth a dollar if it says it's worth a dollar or because it's hard to trade in, is it worth less? And that was highly inefficient.

And one of the really important innovations coming out of the Civil War from a financial perspective was the idea that we had one unit of account, one currency. And that is a much more efficient way to run economy and more importantly, a much more financially stable way to run an economy. So you can have multiple competing forms of private money that are inefficient. You can have very large forms of private money that end up being quite destabilizing. You can think of a stablecoin as a completely unregulated money market fund attached to a payments rail. And that combination is quite explosive, potentially quite dangerous. And that's why Jay Powell has made this clear Vice Chair Brainard when she was at... The Fed made this clear. I've made it clear that stablecoins really do need to have Prudential oversight, prudential supervision because of that risk.

Anna Gelpern:

It did take several national banking acts and some decades and some incentives for the Fed dealing with access to the payment system to actually get that bank note chaos under control, right?

Michael Barr:

Yeah.

Anna Gelpern:

So that hopefully we're not talking for decades.

Michael Barr:

Well, one of the nice things about having the lessons of history is that we don't have to recreate the problems all over again that we've already solved. So I think it's important that we learn from that history and act appropriately and expeditiously.

Anna Gelpern:

Going back though to payment systems in particular and to the coin piece of stablecoin, do you view this debate as at all related to the Central Bank digital currency conversation in the United States or not so much?

Michael Barr:

I think of them as swimming in separate lanes. So if people want to issue stablecoins, we need to have strong prudential oversight of...

Anna Gelpern:

The people.

Michael Barr:

... that people activity. Over the people, over the issuance, over the wallets, over the structure of the mechanism for the transfer of the... Whatever the effect of blockchain is or other mechanism underlying the stablecoins. So all that needs to be supervised and regulated.

There's a separate question which is, "Should the Federal Reserve issue of central bank digital currency?" And people might want that for lots of different reasons than they want a stablecoin. I think they're functionally quite different instruments and so we think of them just as separate sets of issues to work on. At the Fed we're very focused right now on research and development about central bank digital currency. We haven't made any decision about whether we think it's a good idea and we've made it clear that if we move forward on a central bank digital currency, we would ask Congress and the administration for their views and we'd want to do it only if there was a consensus, this was something that was good for the country.

Anna Gelpern:

Now speaking of consensus and going back to your point about financial stability, to what extent...? What do you see as the role of the Financial Stability Oversight Council in this conversation? And I mentioned this both because you mentioned regulators or not federal bank regulators of course [inaudible 00:12:12] as part of FSOC and also the financial stability dimension of it and just hashing out a shared position on what legislation should be in this space.

Michael Barr:

We do spend a lot of time in the financial Stability Oversight Council meetings talking about issues related to crypto asset development and including stablecoins. So it is a forum for conversation. It is a forum for consensus building, as you mentioned, the SEC and CFTC in addition to the federal banking agencies are part of that. We have state regulators as part of the FSOC. So it is a really good forum for discussion of these issues and of exchange of views on these issues.

Anna Gelpern:

Two more quick questions and then I'd like to open this for audience questions. So one is really going to your latest guidance, and it seems to be... And this whole idea of crypto related activities, I mean we're all crypto related to some degree. And so if for example, the business model of an institution is tied in on either side of the balance sheet with the crypto sector, but really with the tulip sector or with the auto sector, isn't that a sort of concentrated funding business model problem? And isn't that something that should have been picked up earlier in just your good old supervisory work? Which leads me to the broader question of when you talk about guardrails, are we talking about guidance about existing guardrails as adapted to this space or are there new guardrails that are...? What's the mix of old and new in the guardrail building space? But first just how much of this can be handled with traditional supervision?

Michael Barr:

Our perspective to date has been quite a lot can be handled with traditional supervision and regulation. The kind of guidance that we're issuing is kind of motherhood and apple pie guidance. Banks should be aware of all the risks they face and take into account those risks and put in place appropriate risk controls. Banks should follow anti-money laundering and anti-terrorist laws. These are pretty basic building blocks of supervision and regulation.

Anna Gelpern:

Don't you think I know that already?

Michael Barr:

Banks that have concentrated risks should conduct themselves with knowledge of those concentrated risks. I think what we've seen with some of the smaller institutions that have gotten involved in providing traditional banking services to crypto related companies is that the extent to which they are exposed to correlated risks was not well understood. And I think what we saw with what people call the crypto winter is that risks in the crypto sector are highly correlated.

And so if you have deposits from crypto related entities, it's highly likely that those entities will suffer stresses in similar ways at the same time. And those stresses might cause wild swings, inflows into deposits and outflows of deposits. And the experience of smaller institutions is that they have actually experienced that and those liquidity risks are really meaningful. And so in our latest guidance we highlighted to banks the importance of taking that seriously.

Anna Gelpern:

Shouldn't somebody have picked that up?

Michael Barr:

I'm sorry.

Anna Gelpern:

Shouldn't somebody have picked that up?

Michael Barr:

Yeah, I do think if you look at the range, particularly of smaller institutions that were involved, we tend to have a very, I would say, light touch approach to smaller institutions. So there's more of an impetus on them to actually be paying attention to these new and novel risks. And we need to make sure that they understand them.

There are obviously larger institutions that are exposed to these risks too, but the exposure tends to be a very, very small part of their balance sheet. And so even if they experience the same deposit outflows, they're more insulated because of the diversification of their balance sheet from the kinds of exposures that they see. And firms of all sizes, whether it's a small bank or a large bank, are exposed to the potential problems associated with some of the illicit financing activity that's been happening in the crypto space. And the need for heightened controls in that space I think is quite acute. So it calls out for, again, heightened risk management, but within the framework that we have, which I think is an appropriate framework for dealing with these issues.

Anna Gelpern:

Well, thank you so much. And I'm deeply tempted to ask about Basel, but I won't. Unfortunately we cannot take questions from the audience online, which is rather large as my phone tells me. But if anyone in the audience here has a question, if you could come up to the microphone, state your name, affiliation, and a question. Microphone.

Nicholas Beran:

Nicholas Beran, The Institute. I remark you mentioned that crypto [inaudible 00:18:27]. Yeah, maybe I should repeat for the online audience. Nicholas Beran, at The Institute. So this policy discussion doesn't take place in an international vacuum. I'm particularly interested in your views on initiatives that have already taken place in other jurisdictions. I'm thinking in particular of the MiCA, Markets in Crypto-Assets, regulations [inaudible 00:18:54] European Union, whether is there a source of ideas and comparison points for the US policy process are basically too different to apply to the specificities of the US situation. Thank you.

Michael Barr:

Thank you. It's good to see you again. If you look around the world, many countries, many jurisdictions around the world are more advanced in their regulatory frameworks than we are here in the United States with respect to how to regulate crypto related activities. The Europeans have a comprehensive framework that's coming into place. The Japanese have a comprehensive framework. But many countries around the world have developed an approach to this sector. Traditionally in the United States it's hard for us to come up with those types of regulatory moments and we have an existing regulatory infrastructure that can be adapted to new products and services. And that is usually the way the United States ends up moving forward with regulating a new kind of product is to say, is this new kind of product like an existing product that we develop? And in what ways can we therefore regulate it using

our existing tools? And in the absence of Congress adapting a different framework that's the framework we use.

So when we think about in the banking sector, when we think about regulating crypto related activities, we don't think, "Aha, we now have a new type of orange. We need to have new orange regulation." We say, "This new orange looks a lot like the oranges that we already eat." And so we think about how to regulate it in that light and modify our rules for any different kinds of risks that are prose by the activity. And again, in the absence of Congress stepping in with comprehensive regulation, I think that's the approach you'll continue to see here in the United States.

Anna Gelpern:

Expanding on that very briefly. So how relevant is the Basel Process and FSB at the moment. They've both sort of provisionally said things in this space. Is it relevant? I mean, going back to your earlier work, does it frame what we do or do we just watch it out of the corner of our eye and see if it's okay?

Michael Barr:

No, we are active participants in the Financial Stability Board and in helping to shape the global framework. So it is reflective in many ways of our views about how to think about these risks. The actions we're taking in the US with respect to regulation of banks engaged in this sector are consistent with the principles that the financial stability board has articulated.

With respect to the Basel Process, the Basel Process has resulted, for example, in a framework for capital treatment of crypto related activities. And that would also be consistent with our thinking about the approach in this area. We don't currently, to our knowledge, have any firms that we regulate that have crypto on the balance sheet, and we've made it clear to firms that we don't think that they should. We don't think it's in our current environment, our current state of governance and controls in the crypto sector, we don't believe that it would be a safe and sound practice for them to do so. So we don't yet have the question of how much capital they should hold if they have it, but those larger frames are consistent with how we're thinking about risks in this area.

Anna Gelpern:

And your bank holding company approach and your approach to foreign bank entry and intermediate holding companies. I mean, it's sort of all on the doorstep, right?

Michael Barr:

Right.

Speaker 4:

Steve.

Michael Barr:

Please.

Steve Kaven:

Hi, am Steve Kaven from American Enterprise Institute. Very nice speech Vice Chair Barr. Thank you. Nice to see you again. I was intrigued by your comment that stablecoins and Central Bank Digital

Currencies or CBDCs were being treated in some sense sort of separately towards considerations and considering that they're both digital currencies and considering that issuance of a CBDC could in principle compete with or even wipe out private stablecoins, I was wondering if you could kind of flesh out your considerations on that. In particular, I'd be interested to know what social value might a private stablecoin offer relative to a CBDC?

Michael Barr:

Thanks, Steve. Good to see you. I do think in the current environment, stablecoins are mostly used by people who want to trade one cryptocurrency for another cryptocurrency in or through an intermediary in the crypto world. So the use case right now is fairly limited, but private stablecoins, as I was mentioning, could be used more broadly for payments. And again, if they do, I think we need to make sure that they are strictly regulated at the federal level for prudential purposes.

The Central Bank Digital Currency also could be used broadly on the payment system. We currently have forms of Central Bank Digital Currency today. We have reserves at banks, for example, that are really a essential component of our payment system. So the question is, "What additional value could you get out of a Central Bank Digital Currency that we don't have out of our current forms of digital currency and our forms of paper currency? Cash."

Cash is still quite important for a lot of people. I almost never use cash, but as I'm sure many people in the audience don't, but for many people, cash is still an important medium exchange and likely will be in the future even if we have a freely available retail Central Bank Digital Currency. So what could Central Bank Digital Currency do? People tend to avoid the kinds of activities into wholesale and retail. On the retail side, the Federal Reserve issued a study last year that basically said, "If we think it makes sense to do further work of retail form of Central Bank Digital Currency, the form of that would be what's called intermediated retail currency." And by intermediated it means the Central Bank wouldn't run around trying to deal directly with households and businesses. Banks or potentially other institutions would be, as they are today, between the Central Bank and the users of that retail Central Bank Digital Currency.

If you go down that road, there are all kinds of questions to ask like, "What are the rules for those intermediaries?" "You have banks or non-bank participants in it." "How much should you worry about disintermediating of the banking system?" That is people holding this form of currency instead of using deposits at a bank for their payments activities. "What would that mean for the allocation of credit in our society?" So there are all kinds of questions around that.

And then there's another set of questions that people raise around privacy, "So how much information would the central bank or other government entities have about the uses?" "Would it be possible to have strong insulation the way we do now between...?" If the government wants to know something about my bank account, they need to demonstrate that they've met the legal requirements for getting access to that information. So you'd want to have similar kinds of privacy protections with respect to a retail Central Bank Digital Currency.

You can imagine some people in thinking about that trade-off preferring a stablecoin that's privately issued to a Central Bank Digital Currency if they're worried about privacy and they don't trust the government with respect to the privacy rules that are put in place.

So those are the kinds of questions people might ask. And then on the wholesale side, "Could a form of central bank digital currency help with reducing frictions and cross-border flow flows?" For example, between banks. "Could it assist with improving efficiency and security in foreign currency transactions?" Those are the kinds of use cases people think about in the wholesale world. But we're very, very early in

this, Steve, so we're very much in the research and development phase. We're not looking to win the central bank digital currency arms race. We're really studying it very, very carefully.

Anna Gelpern:

So Michael, I would love to follow up picking up on some of the things that you mentioned, but really going back to your opening story and the college students who lost a bundle in crypto and which made me think there's a cost to the breadcrumbs approach. In your speech you said regulation needs to be deliberate, it takes time, it responds to real life problems, of which we've had plenty, but thank goodness not 08, 09. But there's a real cost to people from lack of regulatory clarity and as we know in much clearer terms because of the bigger platforms and louder voices, there's a costume institutions. So what's your take on the cost of uncertainty and in particular on the incidents of losses in this space and the disproportionate impact on marginalized in Black and Brown communities in this space?

Michael Barr:

It's a great question. Well, first of all, let me be clear that the crypto activity that resulted in these horrible losses was not in the banking system.

Anna Gelpern:

Not your fault.

Michael Barr:

The banks that we supervise and regulated have pretty limited exposure to crypto related activity, and we're suggesting that they continue to be careful and cautious about those exposures. Even in cases where the banks that we supervise have seen these kinds of exposures result to harm to the bank. The activity the bank was conducting was traditional banking activity that is offering deposit services. So the approach that we're taking for banks is in the context of the fact that banks in general are being careful and cautious in this space. And so we're appropriately tailoring our response to the world that we're working in. It doesn't really speak to the question, "What's the right role for market regulators with respect to all the activity happening outside of the banking system?" Where I think we've seen enormous harm. And as you said, we don't have enough information about the distributional effects, but at least some of the people who are harmed are people who are... Like the students who I met who were just looking for a way to invest in this new technology.

We always have a trade-off with respect to innovative products. So abstracting that away from the current set of circumstances, we have this basic trade off. If you step in too early, you might cut off innovation in a way that is harmful overall to the economy. We need innovation for growth. We need innovation to have a vibrant financial sector to contribute to growth. So you need to intervene in an appropriate way for the stage of development of the thing that you're seeing. And the problem is that regulators are always a little bit behind, just as a general matter, we know less about the innovation and the people doing it. And innovation, as I said in my speech, has these cycles where things can be going pretty calmly and therefore you think you have time to wrap your arms around it. And then they just take off and they move very, very quickly. And then they overwhelm individual decision making. They overwhelm risk management functions.

They are, usually when they're taking off, extremely lucrative and they feel safe because everything's going up. And so people get even more excited and you get a frenzy. And then the cycle turns when you get a sharp break like we saw this last year with the collapse of Terra Luna and an FDX and then a whole

host of other entities, and the risks are revealed. But what we find often is the case that some really basic principles are the same basic principles we've known about all along. So calling something crypto doesn't make it immune from the laws of nature or the basic risks that we see in finance. And that's why I said a lot of what we've said so far is kind of motherhood and apple pie because our basic risk management practices are really useful.

Anna Gelpern:

Yes, but there's the Dodd-Frank moment issue, which is that, assume, and it's real, I have full confidence in your supervisory capacities and execution. It's a perimeter drawing and coordination issue. The fact that something really bad is happening right outside your door to vulnerable people has got to be somebody's problem. And in a way that is what Dodd-Frank tried to address in that context. And it feels like there's demand on all sides for that sort of a holistic take.

Michael Barr:

Yeah, I mean, as I said, be before, I think it would be useful for Congress to have a comprehensive framework here for the reasons that you described. But in the absence of that comprehensive framework, it's important for regulators to use, or existing authorities, both banking regulators and market regulators to do our best to protect the public and protect the financial system. And as I said, inside the banking system, we have the tools we need to do that.

Anna Gelpern:

Thank you so much. This has been incredibly enriching and thought-provoking and important. Please join me in thanking Vice Chair Barr for his insights.